

Notice 2005-13

Part 1 of 5

MEMORANDUM

February 14, 2005

To: Bulletin Unit Coordinator, W:CAR:MP:FP

From: Donna M. Crisalli, CC:ITA

Subject: Referral of Item for Publication

CASE NAME: Tax-Exempt Leasing Involving Defeasance

CASE-MIS No.: NOT-157892-04

INITIATOR'S OFFICE SYMBOLS: CC:ITA:5

INITIATOR'S NAME AND TELEPHONE NUMBER: John Aramburu, 622-7604

The attached item has been approved for publication in the Internal Revenue Bulletin.

Attachment(s)

TO BE PUBLISHED AS:

NOTICE	<u>2005-13</u>
I.R.B. NO.	<u>2005-9</u>
DATED:	<u>Feb. 28, 2005</u>

RECORD OF BULLETIN EDITORIALS

This form is for the use of the Technical Publications Branch in connection with the preparation, review, and approval of material to be published in the Internal Revenue Bulletin.

1. NAME OF FILE (or other identification)			BULLETIN CITATION		
Tax-Exempt Leasing Involving Defeasance			2005-9 IRB		
2. (Check one)					
<input type="checkbox"/> REVENUE RULING		<input type="checkbox"/> TREASURY DECISION		<input type="checkbox"/> COURT DECISION	
<input type="checkbox"/> REVENUE PROC.		<input type="checkbox"/> PROPOSED TREAS. DEC.		<input type="checkbox"/> ANNOUNCEMENT	
<input type="checkbox"/> TAX COURT ANN.		<input type="checkbox"/> PUBLIC LAW		<input checked="" type="checkbox"/> NOTICE	
<input type="checkbox"/> OTHER					
3. MAIN CODE SECTION 167			CROSS REFERENCES		
4. ESTIMATED NUMBER OF PAGES IN BULLETIN (Five typed pages = one bulletin page. Fractions may be expressed in quarters of a page.)					
3 pages					
5. HIGHLIGHT ENTRY (Identify which subject the item should be listed under: Special Announcements, Income Tax, Employee Plans, Exempt Organizations, Estate Tax, Gift Tax, Employment Tax, Self-Employment Tax, Excise Tax, Tax Conventions, Administrative.)					
INCOME TAX					
Notice 2005-13, page					
Tax-Exempt Leasing Involving Defeasance. This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and identifies SILOs as listed transactions.					
6. INDEX ENTRIES (Identify which subject the item should be listed under: Income Tax, Employee Plans, Exempt Organizations, Estate Tax, Gift Tax, Employment Tax, Self-Employment Tax, Excise Tax.)					
INCOME TAX					
Tax-Exempt Leasing Involving Defeasance (NOT 13)					
CODE	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER
NAME	Aranburu	Blaine	Crisalli		
DATE	02-14-05	02-14-05	02-14-05		

M-1889 (Rev. 5/99)

File Edit Action Navigate Option Window Help

Process Referenced

SLO LISTING NOTICE

2005-13

02/28/2005

2005-9

02/14/2005

851

02/14/2005

ANARANGI

GBLANI

11/04/2004

11/05/2004

11/05/2004

11/05/2004

11/05/2004

View Summary

Print Report

Back

Yes

No

Cancel

FRM-40400: Transaction complete. records applied and saved.

Record: 1/6

Ruff Cherita K

From: Aramburu John M
Sent: Tuesday, December 21, 2004 2:17 PM
To: Ruff Cherita K
Subject: FW: Wli for SLI

Cherita, could you handle this? Thanks. --John.

-----Original Message-----

From: Schwimmer Mark I
Sent: Tuesday, December 21, 2004 1:39 PM
To: Aramburu John M
Cc: Crisalli Donna M; Gladden, Andrea
Subject: Wli for SLI

John: Please have a wli created for CC:TEGE on NOT-157892-04 (the SILO notice). Thanks

Andrea: when it comes in, please assign it to me. Thanks.


Ruff Cherita K

From: Aramburu John M
Sent: Friday, December 10, 2004 1:29 PM
To: Ruff Cherita K
Cc: Young Donna Marie
Subject: SILO Listing Notice/ NOT-157892-04

Cherita,

Please open a WLI for PSI in this case.

Thank you.

John Aramburu
Senior Counsel
CC:ITA:5
2-7 

b6

Technis Rev Ruling/Procedures Detail

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Technis Rev Ruling Procedures Detail

SILO LISTING NOTICE	

001	11/04/2004
JMARAMB1	
GJELAIN1	
11/04/2004	
11/04/2004	

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PUBLICATION CASE OPENING DATA FORM

CASE NAME: SILO Listing Notice

CASE-MIS No.: NOT-

DATE OPENED:

TYPE: Notice

INITIATOR: John Aramburu

BRANCH SYMBOLS: CC:ITA:5

SOURCE OF PROJECT: SILO task force

BRANCH REVIEWER: George Blaine

RELATED CASE MIS No(s):

COMMENT(S):

Target Date to be Forwarded to Publications Manager for Assistant Chief Counsel (Field Service) Review
(Complete Only if Less Than 60 Days From the Date Opened):

ISSUE

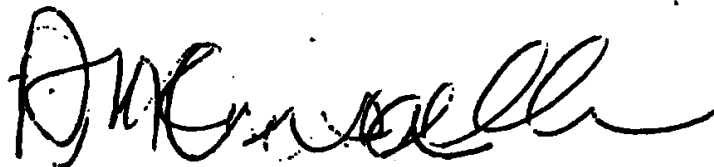
PRIMARY CODE SEC. (UIL): 167.15-02

SECONDARY CODE SEC.(UIL):

SECONDARY CODE SEC.(UIL):

ISSUE(S): Whether a taxpayer entering into a sale-in, lease-out transaction (SILO) acquires and retains the benefits and burdens (and therefore tax ownership) of property.

Macro Form (Rev. 3/98)



FEB-15-2005 13:16

TAX POLICY



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FEB 16 2005

1522 1.000
Havens
Larson
Kob
Hubbard
Desmond
RECEIVED
OFFICE OF CHIEF COUNSEL
P 2:38

The Honorable Norman Y. Mineta
Secretary
U.S. Department of Transportation
400 Seventh Street, SW
Washington, DC 20590

Dear Mr. Secretary:

By letter dated November 26, 2003, Assistant Secretary Pamela F. Olson requested that the Department of Transportation no longer permit "sale-in/lease-out" or "SILO" transactions, noting that the Treasury Department was considering whether, and in what form, to issue published guidance regarding these transactions. On February 11, 2005, the IRS and Treasury Department issued Notice 2005-13, designating SILOs as "listed" tax avoidance transactions in accordance with applicable Treasury Regulations.

The American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (the "Act"), enacted on October 22, 2004, amended various provisions of the Internal Revenue Code to deny the tax benefits from SILO transactions. Section 849(b) of the Act provides that these amendments do not apply to "Qualified Transportation Property." It is our understanding that Congress' intent in enacting this provision was to ensure that the anticipated federal tax benefits relating Qualified Transportation Property be sustained. Consistent with the congressional intent, Notice 2005-13 provides that leases or purported leases involving Qualified Transportation Property are not identified as listed transactions subject to the terms of the Notice.

If you have any questions or need further information, please do not hesitate to contact us.

Sincerely,

Eric Solomon

Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)



Department of the Treasury

Departmental Offices

Office _____

Office Phone Number

622-4277

Fax Phone Number _____

FAX TRANSMITTAL SHEET

Date: 2/15/05

Time: _____

To: Mr. Korb

Phone Number _____

From: Eric Solomon622-

Phone Number

Number of Pages: 2
(including this page)Comments: _____

If problems occur with this transmission, please notify sender on the Office Phone Number above.

66

ACKNOWLEDGEMENT OF RECEIPT

I hereby acknowledge receipt of the Congressional Review Act Reports (and attachments) with respect to Notice 2005-13, TD 9180, and Rev. Rule 2005-12 on 2-24-05.
DATE

The Office of the Honorable J. Dennis Hastert

B. Cooper
SIGNATURE

B. Cooper
PRINT NAME

John
Aramburo
file

FEL

ACKNOWLEDGEMENT OF RECEIPT

I hereby acknowledge receipt of the Congressional Review Act Reports (and attachments) with respect to Notice 2005-13, TD 9180, and Rev. Rule 2005-12
on 2-24

DATE

The Office of the Honorable Richard Cheney


SIGNATURE

MURPHY
PRINT NAME

FEB 23 2005



DEPARTMENT OF THE TREASURY
WASHINGTON

MEMORANDUM FOR: Robert M. Brown
Associate Chief Counsel (IT&A)

FROM: Helen M. Hubbard *H. Hubbard*
Tax Legislative Counsel

SUBJECT: Tax-Exempt Leasing Involving Defeasance
(CASE-MIS NOT 157892-04)

DATE: February 11, 2005

We approve the attached notice for publication in the Internal Revenue Bulletin. The notice alerts taxpayers and their representatives that transactions in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited are tax avoidance transactions. The notice identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. The notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Attachment

cc: Eric Solomon
Bob Carroll
Helen Hubbard
Jonathan Ackerman
Michael Desmond

Don Korb
Don Rocen
Nick DeNovio
Jonathan Zelnik
John Arambaru
Donna Crisalli

	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	SECRETARIAT
OFFICE CODE SURNAME	XLC/Ackerman	XLC/Hubbard				
INITIALS/DATE	JZH / 2/11/05	H. Hubbard / 2/11/05				

Part III – Administrative, Procedural, and Miscellaneous

Tax-Exempt Leasing Involving Defeasance

Notice 2005-13

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S. taxpayer. FP is a tax-indifferent person that owns and uses certain property.¹ BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of \$105x and X makes a single payment of \$105x to FP. To fund the \$105x payment, X provides \$15x in

¹ In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.

equity and borrows \$81x from BK1 and \$9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance the acquisition of new assets. Upon receiving the \$105x purchase price payment, FP sets aside substantially all of the \$105x to satisfy its lease obligations. FP deposits \$81x with BK3 and \$9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the parties treat these

amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a result, neither bank bears a significant risk of nonpayment.²

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial

² The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.

equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest \$9x of the \$105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease.³ Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining \$6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined

³ The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating.

minimum capacity payments sufficient to provide X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option. Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and

Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination

Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. Gregory v. Helvering, 293 U.S. 465 (1935). In Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978), the Supreme Court stated that "[i]n applying the doctrine of substance over

form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in Frank Lyon to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in Frank Lyon as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." Frank Lyon, 435 U.S. at 584. The Court subsequently relied on its approach in Frank Lyon to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. Nebraska Dep't of Revenue v. Loewenstein, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional owner, including "the benefits and burdens of ownership." Coleman v. Commissioner, 16 F.3d 821, 826 (7th Cir. 1994) (citing Frank Lyon, 435 U.S. at 582-84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in Frank Lyon.

First, in Frank Lyon, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the

\$105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining \$6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in Frank Lyon, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. Frank Lyon, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan balances or forfeiting its equity investment.

Third, in Frank Lyon, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the

determination of tax ownership. See, e.g., Swift Dodge v. Commissioner, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the

leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. See Kwiat v. Commissioner, T.C. Memo. 1992-433 (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); see also Aderholt Specialty Co. v. Commissioner, T.C. Memo. 1985-491; Rev. Rul. 72-543, 1972-2 C.B. 87. In contrast, in Frank Lyon, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. See Hilton v. Commissioner, 74 T.C. 305 (1980), aff'd, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax

benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. Cf. Rev. Rul. 2002-69, 2002-2 C.B. 760 (disregarded offsetting obligations in a LIFO arrangement gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. See H. R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662-663 (2004). These amendments generally are effective for leases entered into after March 12, 2004.⁴

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described

⁴ Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.

in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A.⁵ Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.

The Service and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu on (202) 622-4960 (not a toll-free call).

⁵ Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005-11, 2005-7 I.R.B. 493.



DEPARTMENT OF THE TREASURY
WASHINGTON

MEMORANDUM FOR: Robert M. Brown
Associate Chief Counsel (IT&A)

FROM: Helen M. Hubbard *H. Hubbard*
Tax Legislative Counsel

SUBJECT: Tax-Exempt Leasing Involving Defeasance
(CASE-MIS NOT 157892-04)

DATE: February 11, 2005

We approve the attached notice for publication in the Internal Revenue Bulletin. The notice alerts taxpayers and their representatives that transactions in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited are tax avoidance transactions. The notice identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. The notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Attachment

cc: Eric Solomon
Bob Carroll
Helen Hubbard
Jonathan Ackerman
Michael Desmond

Don Korb
Don Rocen
Nick DeNovio
Jonathan Zelnik
John Arambaru
Donna Crisalli

	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	SECRETARIAT
OFFICE CODE SURNAME	XLC/Hackman	XLC/Hackman				
INITIALS/DATE	JZ/H / 2/11/05	H. Hubbard / 2/11/05				

Part III – Administrative, Procedural, and Miscellaneous

Tax-Exempt Leasing Involving Defeasance

Notice 2005-13

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S. taxpayer. FP is a tax-indifferent person that owns and uses certain property.¹ BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of \$105x and X makes a single payment of \$105x to FP. To fund the \$105x payment, X provides \$15x in

¹ In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.

equity and borrows \$81x from BK1 and \$9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance the acquisition of new assets. Upon receiving the \$105x purchase price payment, FP sets aside substantially all of the \$105x to satisfy its lease obligations. FP deposits \$81x with BK3 and \$9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the parties treat these

amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a result, neither bank bears a significant risk of nonpayment.²

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial

² The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.

equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest \$9x of the \$105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease.³ Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining \$6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined

³ The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating.

minimum capacity payments sufficient to provide X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option.

Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and

Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination

Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. Gregory v. Helvering, 293 U.S. 465 (1935). In Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978), the Supreme Court stated that "[i]n applying the doctrine of substance over

form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in Frank Lyon to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in Frank Lyon as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." Frank Lyon, 435 U.S. at 584. The Court subsequently relied on its approach in Frank Lyon to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. Nebraska Dep't of Revenue v. Loewenstein, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional owner, including "the benefits and burdens of ownership." Coleman v. Commissioner, 16 F.3d 821, 826 (7th Cir. 1994) (citing Frank Lyon, 435 U.S. at 582-84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in Frank Lyon.

First, in Frank Lyon, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the

\$105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining \$6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in Frank Lyon, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. Frank Lyon, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan balances or forfeiting its equity investment.

Third, in Frank Lyon, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the

determination of tax ownership. See, e.g., Swift Dodge v. Commissioner, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the

leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. See Kwiat v. Commissioner, T.C. Memo. 1992-433 (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); see also Aderholt Specialty Co. v. Commissioner, T.C. Memo. 1985-491; Rev. Rul. 72-543, 1972-2 C.B. 87. In contrast, in Frank Lyon, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. See Hilton v. Commissioner, 74 T.C. 305 (1980), aff'd, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax

benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. Cf. Rev. Rul. 2002-69, 2002-2 C.B. 760 (disregarded offsetting obligations in a LILO arrangement gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. See H. R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662-663 (2004). These amendments generally are effective for leases entered into after March 12, 2004.⁴

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described

⁴ Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.

in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A.⁵ Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.

The Service and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu on (202) 622-4960 (not a toll-free call).

⁵ Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005-11, 2005-7 I.R.B. 493.



DEPARTMENT OF THE TREASURY
WASHINGTON

MEMORANDUM FOR: Robert M. Brown
Associate Chief Counsel (IT&A)

FROM: Helen M. Hubbard *H. Hubbard*
Tax Legislative Counsel

SUBJECT: Tax-Exempt Leasing Involving Defeasance
(CASE-MIS NOT 157892-04)

DATE: February 11, 2005

We approve the attached notice for publication in the Internal Revenue Bulletin. The notice alerts taxpayers and their representatives that transactions in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited are tax avoidance transactions. The notice identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. The notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Attachment

cc: Eric Solomon
Bob Carroll
Helen Hubbard
Jonathan Ackerman
Michael Desmond

Don Korb
Don Rocen
Nick DeNovio
Jonathan Zelnik
John Arambaru
Donna Crisalli

	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	SECRETARIAT
OFFICE CODE SURNAME	XLC/Hackman	XLC/Hackman				
INITIALS/DATE	JZA/2/11/05	Hunt/2/11/05				

Part III – Administrative, Procedural, and Miscellaneous

Tax-Exempt Leasing Involving Defeasance

Notice 2005-13

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S. taxpayer. FP is a tax-indifferent person that owns and uses certain property.¹ BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of \$105x and X makes a single payment of \$105x to FP. To fund the \$105x payment, X provides \$15x in

¹ In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.

equity and borrows \$81x from BK1 and \$9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance the acquisition of new assets. Upon receiving the \$105x purchase price payment, FP sets aside substantially all of the \$105x to satisfy its lease obligations. FP deposits \$81x with BK3 and \$9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the parties treat these

amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a result, neither bank bears a significant risk of nonpayment.²

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial

² The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.

equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest \$9x of the \$105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease.³ Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining \$6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined

³ The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating.

minimum capacity payments sufficient to provide X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option. Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and

Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination

Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. Gregory v. Helvering, 293 U.S. 465 (1935). In Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978), the Supreme Court stated that "[i]n applying the doctrine of substance over

form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in Frank Lyon to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in Frank Lyon as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." Frank Lyon, 435 U.S. at 584. The Court subsequently relied on its approach in Frank Lyon to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. Nebraska Dep't of Revenue v. Loewenstein, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional owner, including "the benefits and burdens of ownership." Coleman v. Commissioner, 16 F.3d 821, 826 (7th Cir. 1994) (citing Frank Lyon, 435 U.S. at 582-84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in Frank Lyon.

First, in Frank Lyon, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the

\$105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining \$6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in Frank Lyon, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. Frank Lyon, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan balances or forfeiting its equity investment.

Third, in Frank Lyon, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the

determination of tax ownership. See, e.g., Swift Dodge v. Commissioner, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the

leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. See Kwiat v. Commissioner, T.C. Memo. 1992-433 (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); see also Aderholt Specialty Co. v. Commissioner, T.C. Memo. 1985-491; Rev. Rul. 72-543, 1972-2 C.B. 87. In contrast, in Frank Lyon, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. See Hilton v. Commissioner, 74 T.C. 305 (1980), aff'd, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax

benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. Cf. Rev. Rul. 2002-69, 2002-2 C.B. 760 (disregarded offsetting obligations in a LILO arrangement gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. See H. R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662-663 (2004). These amendments generally are effective for leases entered into after March 12, 2004.⁴

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described

⁴ Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.

in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A.⁵ Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.

The Service and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu on (202) 622-4960 (not a toll-free call).

⁵ Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005-11, 2005-7 I.R.B. 493.

File copy

Submission of Federal Rules Under the Congressional Review Act

☐ President of the Senate ☐ Speaker of the House of Representatives ☐ GAO

Please fill the circles electronically or with a black pen or a #2 pencil.

1. Name of Department or Agency Department of the Treasury	2. Subdivision or Office Internal Revenue Service
3. Rule Title Tax-Exempt Leasing Involving Defeasance	
4. Regulation Identifying Number (RIN) or other Unique Number (if applicable) Notice 2005-13	
5. Major Rule <input type="radio"/> Non-major rule <input checked="" type="radio"/>	
6. Final Rule <input type="radio"/> Other <input checked="" type="radio"/> IRB ONLY	
7. With respect to this rule, did your agency solicit public comments? Yes <input type="radio"/> No <input checked="" type="radio"/>	
8. Priority of Regulation (fill in one) <div style="display: flex; justify-content: space-between;"><div><input checked="" type="radio"/> Economically Significant ; or Significant; or Substantive, Nonsignificant</div><div><input type="radio"/> Routine and Frequent or Informational/Administrative/Other (Do not complete the other side of this form if filled in above.)</div></div>	
9. Effective date (if applicable) February 11, 2005	
10. Concise Summary of Rule (fill in one or both) attached <input checked="" type="radio"/> stated in rule <input type="radio"/>	

Submitted by: _____ (signature)

Name: Cynthia E. Grigsby
Title: Acting Chief, Publications and Regulations Branch

For further information contact: Donna Crisalli at 622-4800

For Congressional Use Only:

Date Received: _____

Committee of Jurisdiction: _____

	Yes	No	N/A
A. With respect to this rule, did your agency prepare an analysis of costs and benefits?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
B. With respect to this rule, by the final rulemaking stage, did your agency			
1. certify that the rule would not have a significant economic impact on a substantial number of small entities under 5 U.S.C. § 605(b)?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
2. prepare a final Regulatory Flexibility Analysis under 5 U.S.C. § 604(a)?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
C. With respect to this rule, did your agency prepare a written statement under § 202 of the Unfunded Mandates Reform Act of 1995?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
D. With respect to this rule, did your agency prepare an Environmental Assessment or an Environmental Impact Statement under the National Environmental Policy Act (NEPA)?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
E. Does this rule contain a collection of information requiring OMB approval under the Paperwork Reduction Act of 1995	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
F. Did you discuss any of the following in the preamble to the rule?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• E.O. 13132, Federalism	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• E.O. 12630, Government Actions and Interference with Constitutionally Protected Property Rights?	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• E.O. 12866, Regulatory Planning and Review	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• E.O. 12988, Civil Justice Reform	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• E.O. 13045, Protection of Children from Environmental Health Risks and Safety Risks	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
• Other statutes or executive orders discussed in the preamble concerning the rulemaking process (please specify): None			

Part III – Administrative, Procedural, and Miscellaneous

Tax-Exempt Leasing Involving Defeasance

Notice 2005-13

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S. taxpayer. FP is a tax-indifferent person that owns and uses certain property.¹ BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of \$105x and X makes a single payment of \$105x to FP. To fund the \$105x payment, X provides \$15x in

¹ In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.

equity and borrows \$81x from BK1 and \$9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance the acquisition of new assets. Upon receiving the \$105x purchase price payment, FP sets aside substantially all of the \$105x to satisfy its lease obligations. FP deposits \$81x with BK3 and \$9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the parties treat these

amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a result, neither bank bears a significant risk of nonpayment.²

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial

² The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.

equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest \$9x of the \$105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease.³ Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining \$6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined

³ The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating.

minimum capacity payments sufficient to provide X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option. Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and

Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination

Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. Gregory v. Helvering, 293 U.S. 465 (1935). In Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978), the Supreme Court stated that "[i]n applying the doctrine of substance over

form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in Frank Lyon to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in Frank Lyon as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." Frank Lyon, 435 U.S. at 584. The Court subsequently relied on its approach in Frank Lyon to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. Nebraska Dep't of Revenue v. Loewenstein, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional owner, including "the benefits and burdens of ownership." Coleman v. Commissioner, 16 F.3d 821, 826 (7th Cir. 1994) (citing Frank Lyon, 435 U.S. at 582-84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in Frank Lyon.

First, in Frank Lyon, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the

\$105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining \$6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in Frank Lyon, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. Frank Lyon, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan balances or forfeiting its equity investment.

Third, in Frank Lyon, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the

determination of tax ownership. See, e.g., Swift Dodge v. Commissioner, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the

leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. See Kwiat v. Commissioner, T.C. Memo. 1992-433 (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); see also Aderholt Specialty Co. v. Commissioner, T.C. Memo. 1985-491; Rev. Rul. 72-543, 1972-2 C.B. 87. In contrast, in Frank Lyon, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. See Hilton v. Commissioner, 74 T.C. 305 (1980), aff'd, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax

benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. Cf. Rev. Rul. 2002-69, 2002-2 C.B. 760 (disregarded offsetting obligations in a LILO arrangement gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. See H. R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662-663 (2004). These amendments generally are effective for leases entered into after March 12, 2004.⁴

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described

⁴ Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.

in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A.⁵ Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.

The Service and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu on (202) 622-4960 (not a toll-free call).

⁵ Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005-11, 2005-7 I.R.B. 493.

Attachment 2

CONCISE GENERAL STATEMENT

Notice 2005-13

Notice 2005-13 disallows tax benefits, including depreciation deductions, claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and identifies SILOs as listed transactions.



DEPARTMENT OF THE TREASURY
WASHINGTON

MEMORANDUM FOR: Robert M. Brown
Associate Chief Counsel (IT&A)

FROM: Helen M. Hubbard *H. Hubbard*
Tax Legislative Counsel

SUBJECT: Tax-Exempt Leasing Involving Defeasance
(CASE-MIS NOT 157892-04)

DATE: February 11, 2005

We approve the attached notice for publication in the Internal Revenue Bulletin. The notice alerts taxpayers and their representatives that transactions in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited are tax avoidance transactions. The notice identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. The notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Attachment

cc: Eric Solomon
Bob Carroll
Helen Hubbard
Jonathan Ackerman
Michael Desmond

Don Korb
Don Rocen
Nick DeNovio
Jonathan Zelnik
John Arambaru
Donna Crisalli

	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	SECRETARIAT
OFFICE CODE SURNAME	XLC/Hackerman	XLC/Hubbard				
INITIALS/DATE	JZH / 2/11/05	H. Hubbard / 2/11/05				



DEPARTMENT OF THE TREASURY
OFFICE OF TAX POLICY
1500 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20220

DATE: 2-11-05

Number of Pages: 2 (including cover)

TO: Jon Zalnrik

Addressee's FAX Number: 2-4277

Addressee's Confirmation Number:

FROM: Helen Hurlbarch

Tel. No: (202) 622- [REDACTED]

56

Sender's FAX Number: (202) 622-9260

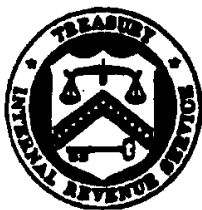
Location: Room 1322 M.T.

Sender's Confirmation Number: (202) 622-

Comments/Special Instructions:

NOTE: THIS MESSAGE IS INTENDED ONLY FOR THE USE OF THE INDIVIDUAL OR ENTITY TO WHOM IT IS ADDRESSED AND MAY CONTAIN INFORMATION THAT IS PRIVILEGED, CONFIDENTIAL AND/OR RESTRICTED AS TO OR EXEMPT FROM DISCLOSURE UNDER APPLICABLE LAWS. If the recipient of this message is not the addressee (i.e., the intended recipient, you are hereby notified that you should not read this document and that any dissemination, distribution, or copying of this communication except insofar as necessary to deliver this document to the intended recipient, is strictly prohibited. If you have received this communication in error, please notify the sender immediately by telephone, and you will be provided further instruction about the return or destruction of the this document. Thank you.

UNCLASSIFIED



Routing and Transmittal Form

Internal Revenue Service Office of Chief Counsel

SEND TO:	Symbols	Room & Bldg	Action(s)	Initials	Date
Deputy Chief Counsel	CC	3034	1		
1 Approval	3 Comment	5 Correction	7 Information	9 Note and Return	11 Signature/Initials
2 As Requested	4 Coordination	6 File This	8 Necessary Action	10 Per Conversation	12 Other (Specify)

RE: Tax-Exempt Leasing Involving Defeasance
(NOT-157892-04)

CC:ITA has approved the attached proposed notice (which is on the published guidance plan) and is forwarding it for your approval or other disposition. We have forwarded the proposed notice electronically to the Office of Tax Legislative Counsel (Jon Ackerman). Please see the enclosed executive summary for additional information.

A Chief Counsel disposition form is attached. Please contact Doug Fahey (622-) and Donna Crisalli (6220-) when you have completed the disposition form, or if you have any questions or comments.

56
JAC
H. M. Pils

FROM: John Aramburu	
Symbols: CC:ITA:05	Phone/FAX: 622-
Date Sent: December 21, 2004	Room/Bldg: 4236 Internal Revenue Building
Macro Form (Rev. 6/2001)	Department of the Treasury Internal Revenue Service

56

CHIEF COUNSEL DISPOSITION FORM

Date:

To: Associate Chief Counsel (Income Tax & Accounting)

From: Chief Counsel

Subject: Tax-Exempt Leasing Involving Defeasance
(NOT-157892-04)

☒

Approved for the Chief Counsel.

☐

Brief the Chief Counsel

☐

Other/Comments:

Initials:

[Handwritten signature]

Rec'd 1/10/05
DAF

ASSOCIATE CHIEF COUNSEL (IT&A) DISPOSITION FORM

Date:

To: Special Counsel to the Associate Chief Counsel
(Income Tax & Accounting)

From: Deputy Associate Chief Counsel (Income Tax & Accounting)

Subject: Tax-Exempt Leasing Involving Defeasance
(NOT-157892-04)

☒

Approved for the Associate Chief Counsel (Income Tax & Accounting)

☐

Brief the Associate Chief Counsel (Income Tax & Accounting)

☐

Other/Comments:

Initials:

George Blane
12-21-04

ASSOCIATE CHIEF COUNSEL (IT&A) DISPOSITION FORM

Date:

To: Special Counsel to the Associate Chief Counsel
(Income Tax & Accounting)

From: Deputy Associate Chief Counsel (Income Tax & Accounting)

Subject: Tax-Exempt Leasing Involving Defeasance
(NOT-157892-04)



Approved for the Associate Chief Counsel (Income Tax & Accounting)



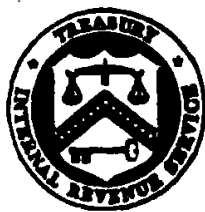
Brief the Associate Chief Counsel (Income Tax & Accounting)



Other/Comments:

Initials:

George Blame
12-21-04



Routing and Transmittal Form

Internal Revenue Service B Office of Chief Counsel

SEND TO: Symbols Room & Bldg B Action(s) B Initials B Date

George Blaine

CC:ITA

4044

1/11

[Signature]
12-21-04

1 Approval	3 Comment	5 Correction	7 Information	9 Note and Return	11 Signature/Initials
2 As Requested	4 Coordination	6 File This	8 Necessary Action	10 Per Conversation	12 Other (Specify)

RE: Tax-Exempt Leasing Involving Defeasance
(NOT-157892-04)

The attached proposed publication item is forwarded for your approval or other disposition. A copy has been forwarded to the Office of Tax Legislative Counsel at Treasury.

An Associate Chief Counsel disposition form is attached. Please contact John Aramburu at 622-[REDACTED] when you have completed the disposition form, if you have any questions or comments, or if you would like to be briefed on this matter.

b6

FROM: Donna M. Crisalli

Symbols: CC:ITA

Phone/FAX: 622-[REDACTED]

Date Sent: December 17, 2004

Room/Bldg: 4050 Internal Revenue Building

b6

Aramburu John M

From: Aramburu John M
Sent: Tuesday, November 09, 2004 9:20 AM
To: O'Connor David F P
Subject: RE: SILOs - Call to Cary Allen on 11/10/04

Dave,

We are to call Cary (704-566-) at 10 tomorrow. I will drop by your office then.

56

--John.

-----Original Message-----

From: O'Connor David F P
Sent: Tuesday, November 09, 2004 8:02 AM
To: Aramburu John M
Subject: SILOs - Call to Cary Allen on 11/10/04

John:

I am available except between 12 & 2. Could you call Cary today, pick a time & advise me of same?

Dave
Tracking:

Recipient
O'Connor David F P

Read
Read: 11/10/2004 9:13 AM

Aramburu John M

From: Zelnik Jonathan R
Sent: Monday, December 20, 2004 2:54 PM
To: Aramburu John M
Subject: Re: CIRC. -- SILO Listing Notice -- 12/18/04

Please include [REDACTED] (with your changes) and let her know that it is the signature copy. b5

-----Original Message-----

From: Aramburu John M <John.M.Aramburu@IRSCOUNSEL.TREAS.GOV>
To: Zelnik Jonathan R <Jonathan.R.Zelnik@IRSCOUNSEL.TREAS.GOV>
CC: O'Connor David F P <David.F.P.O'Connor@irscounsel.treas.gov>; Blaine George J <George.J.Blaine@irscounsel.treas.gov>
Sent: Mon Dec 20 14:50:49 2004
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Jon,

1. Should I include the sentence [REDACTED] b5
2. Should I advise Melissa the document is a signature copy?

--John.

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 20, 2004 2:47 PM
To: Aramburu John M; Crisalli Donna M
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Thank you for the e-mail regarding the status. Please send me the current draft of the Notice and I will take care of circulating to those that are interested.

Thanks,
Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-[REDACTED]
Fax: (202) 283-7170 b6

-----Original Message-----

From: Aramburu John M
Sent: Monday, December 20, 2004 1:46 PM
To: Crisalli Donna M; Arndt Melissa D
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

Thanks to all who commented. I am responding to your request that we notify you of how the comments were handled.

Cary Allen had essentially two comments. O [REDACTED] b5

[REDACTED] Cary
agreed that this could be discussed in the CIP.

Frank McClanahan made a number of comments, all of which were based on [REDACTED] and that we can revisit the issue when completing the CIP.

Diane Mirabito made three comments. We adopted two: [REDACTED] b5

Amy Liberator made the same comment as Diane [REDACTED] She also mentioned that [REDACTED]

Michael Winters pointed out that [REDACTED] We edited the Notice to reflect this, although, at the recommendation of CC:PSI, [REDACTED]

Should I send you or someone else at Division Counsel a draft that incorporates adopted changes?

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED] b6

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED] b6

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?

<< Message: FW: CIRC. -- SILO Listing Notice -- 12/18/04 >> Thanks,

Melissa D. Arndt

(Hyche Vicki J); Rogelio Villageliu (Villageliu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahanIII@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following techmis file:
2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

THE ATTACHED DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE. YOU ARE HEREBY NOTIFIED THAT ANY DISCLOSURE, COPYING, OR DISTRIBUTION, OR THE TAKING OF ANY ACTION IN RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS OFFICIAL POSITIONS OF THE IRS.

<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

Aramburu John M

From: Arndt Melissa D
Sent: Monday, December 20, 2004 2:47 PM
To: Aramburu John M; Crisalli Donna M
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Thank you for the e-mail regarding the status. Please send me the current draft of the Notice and I will take care of circulating to those that are interested.

Thanks,
Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

-----Original Message-----

From: Aramburu John M
Sent: Monday, December 20, 2004 1:46 PM
To: Crisalli Donna M; Arndt Melissa D
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

Thanks to all who commented. I am responding to your request that we notify you of how the comments were handled.

Cary Allen had essentially two comments. [REDACTED]

[REDACTED] Cary's second comment.

Cary agreed that this could be discussed in the CIP.

Frank McClanahan made a number of comments, all of which were based on the [REDACTED]

[REDACTED] revisit the issue when completing the CIP.

b5

Diane Mirabito made three comments. We adopted two: [REDACTED]

[REDACTED]

Amy Liberator made the same comment as Diane [REDACTED]

Michael Winters pointed out that [REDACTED] We edited the Notice to reflect this, although, at the recommendation of CC:PSI, [REDACTED]

Should I send you or someone else at Division Counsel a draft that incorporates adopted changes?

John Aramburu
Senior Counsel

CC:ITA:5

2- [REDACTED]

b6

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED]

b6

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?

<< Message: FW: CIRC. -- SILO Listing Notice -- 12/18/04 >> Thanks,

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-8626
Fax: (202) 283-7176

-----Original Message-----

From: McClanahan III Frank C
Sent: Monday, December 13, 2004 8:40 AM
To: Arndt Melissa D
Cc: Dow Harmon B
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

b5

MAC

-----Original Message-----

From: Dow Harmon B

Sent: Friday, December 10, 2004 4:25 PM

To: William Merkle (Merkle William G); Benjamin De Luna (De Luna Benjamin A); Fried Clint M (Clint.M.Fried@IRSCOUNSEL.TREAS.GOV); Gannon Richard H (Richard.H.Gannon@IRSCOUNSEL.TREAS.GOV); James Lanning (James.C.Lanning@IRSCOUNSEL.TREAS.GOV); Pam Gibson V (Gibson Pam V); Reid Huey (Huey Reid M); Bob Shilliday Jr (Shilliday Robert Jr J); Steven Guest (Guest Steven R); Vicki Hyche (Hyche Vicki J); Rogelio Villagellu (Villagellu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahan@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)

Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following techmis file:

2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D

Sent: Friday, December 10, 2004 3:27 PM

To: BLM PG Circ; BLM Shelters

Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

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<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

Aramburu John M

From: Zelnik Jonathan R
Sent: Monday, December 20, 2004 1:24 PM
To: Aramburu John M
Subject: Re: SILO listing -- naming TE/GE accommodation parties

Yes on ready for signature circulation. I'd send Melissa the email. I'm not sure who we should go to for lmsb clearance. Why not ask Melissa if there is someone from lmsb that is positioned to signoff on the current draft.

-----Original Message-----

From: Aramburu John M <John.M.Aramburu@IRSCOUNSEL.TREAS.GOV>
To: Zelnik Jonathan R <Jonathan.R.Zelnik@IRSCOUNSEL.TREAS.GOV>
CC: O'Connor David F P <David.F.P.O'Connor@irscounsel.treas.gov>; Blaine George J <George.J.Blaine@irscounsel.treas.gov>
Sent: Mon Dec 20 13:14:15 2004
Subject: RE: SILO listing -- naming TE/GE accommodation parties

I might change [REDACTED]

[REDACTED] b5
[REDACTED]
[REDACTED], do you think the clearance draft is otherwise set so that I should prepare an email message to Melissa setting forth our disposition of the various commentary from LMSB? Do we need LMSB approval to circulate a signature package?

-----Original Message-----

From: Zelnik Jonathan R
Sent: Monday, December 20, 2004 12:59 PM
To: Terry Thomas D; Ingram Sarah H; Marks Nancy J; Young Donna Marie
Cc: Aramburu John M; Blaine George J; Aramburu John M
Subject: FW: SILO listing -- naming TE/GE accommodation parties

Here is possible language [REDACTED]

[REDACTED] Once we agree on language, we will add to the notice, circulate the signature package, and send the notice to Eric Solomon. [REDACTED] b5
[REDACTED]

-----Original Message-----

From: Klotsche John C [mailto:John.C.Klotsche@irs.gov]
Sent: Saturday, December 18, 2004 5:10 PM
To: Ingram Sarah H
Cc: Terry Thomas D; Miller Steven T; Marks Nancy J; 'Hubbard Helen - OTP'; 'Ackerman Jonathan - OTP'; Zelnik Jonathan R; Ashford Tamara W
Subject: SILO listing -- naming TE/GE accommodation parties

Aramburu John M

From: Zelnik Jonathan R
Sent: Friday, December 17, 2004 4:45 PM
To: Aramburu John M
Cc: O'Connor David F P; Blaine George J
Subject: RE: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Steve's re-write slightly changes the emphasis of the sentence. I'd leave the way it is in the version incorporating the other green sheet comments.

-----Original Message-----

From: Aramburu John M
Sent: Friday, December 17, 2004 1:56 PM
To: Zelnik Jonathan R; O'Connor David F P; Blaine George J
Subject: FW: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

-----Original Message-----

From: Gibbs Steve A [mailto:Steve.A.Gibbs@irs.gov]
Sent: Friday, December 17, 2004 1:51 PM
To: Aramburu John M
Cc: Onken Steven P; Ryan Diane S; Gibbs Steve A
Subject: RE: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

JOHN,

I COULDN'T SEND THIS E-MAIL TO DONNA SO I THOUGHT IT WOULD BE OK TO SEND IT TO YOU.

THE ONLY CHANGE I'D RECOMMEND IS SUMMARIZED BELOW. FROM [REDACTED]

[REDACTED]

[REDACTED]

b5

I'D CHANGE THE SENTENCE TO READ AS FOLLOWS:

[REDACTED]

STEVE GIBBS (305-982-[REDACTED])

b6

-----Original Message-----

From: Roth Timothy M
Sent: Monday, December 13, 2004 7:43 AM

To: Onken Steven P; Gibbs Steve A
Subject: FW: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Steve, please look this over and provide any response directly to Ms. Crisalli with a copy to Diane Ryan.

Thanks

Timothy M. Roth
 Appeals Technical Advisor
 Office of Technical Guidance
 Tel: 217-862-
 Fax: 217-862-6322

-----Original Message-----

From: Ryan Diane AP
Sent: Friday, December 10, 2004 1:30 PM
To: Roth Timothy M
Subject: FW: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Diane S. Ryan
 Director of Technical Guidance, Appeals
 (314) 612-

-----Original Message-----

From: Crisalli Donna M [<mailto:Donna.M.Crisalli@irs.counsel.treas.gov>]
Sent: Friday, December 10, 2004 1:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions. Comments are requested by COB December 17.

<<...>> <<...>>

Donna M. Crisalli
 Special Counsel (ITA)

12/20/2004

Room 4050
(202) 622- [REDACTED]

50

Aramburu John M

From: Zelnik Jonathan R
Sent: Friday, December 17, 2004 11:30 AM
To: Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Follow Up Flag: Follow up
Flag Status: Flagged

When you compile responses to Melissa, you may want to address these two points. (1) We'll cover in CIP. (2) If I recall correctly, [REDACTED] 55

-----Original Message-----

From: Liberator Amy [mailto:Amy.Liberator@irs.gov]
Sent: Friday, December 17, 2004 9:42 AM
To: Arndt Melissa D
Cc: Zelnik Jonathan R; Allen Cary D; Autry Patricia J; Snyder Robert; Claybough Cheryl P
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

I like the additions that were made to the Notice and have the following comments:

1) The Legal Analysis relating to the [REDACTED]

2) I think the [REDACTED] associated with the SILOs should be addressed in the Facts and Legal Analysis. 55

Jon - Bob Snyder and I have not seen any situations [REDACTED]
[REDACTED] The only thing that came to mind [REDACTED]
but I don't think that is what you're looking for. I left a message for Cary about this so hopefully he'll contact you if he has seen such a situation.

Thanks for seeking our input. Have a great weekend!

Amy Liberator
Technical Advisor - Leasing
2 South Main St. Room 395 Akron, OH 44308
Phone: 330-253-[REDACTED]
Fax: 330-253-7232
Visit the Leasing TA Website at: <http://lmsb.irs.gov/hq/pftg/leasing/index.asp> 56

-----Original Message-----

From: O'Donnell Douglas W
Sent: Friday, December 10, 2004 4:29 PM
To: Claybough Cheryl P
Cc: DeNard Paul D; Allen Cary D; Autry Patricia J; Liberator Amy
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Cheryl,

Please share as appropriate. Comments are necessary in one week.

Douglas W. O'Donnell
Deputy Director Pre-Filing & Technical Guidance
Washington, DC
202.283. [REDACTED] (Phone)
240.271.4835 (Cell)

-----Original Message-----

From: Arndt Melissa D [mailto:Melissa.D.Arndt@irs.counsel.treas.gov]
Sent: Friday, December 10, 2004 4:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

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SILO Notice Green
12-10-04.doc...

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283- [REDACTED]
Fax: (202) 283-7176

56

Aramburu John M

From: Hartford Susan L
Sent: Friday, December 17, 2004 5:33 PM
To: Aramburu John M; Blaine George J
Cc: Wall Judith M; Daniels Patrice A
Subject: Comments on Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Follow Up Flag: Follow up
Flag Status: Flagged

I have reviewed the proposed executive summary and notice on behalf of the Special Counsel to the NTA and made some suggested editorial changes as well as some substantive comments ([REDACTED]) A redline version is attached with my comments noted in the margin. With regard to the executive summary, I note that it does not appear as if it has been coordinated with CC:PA:APJP:B02 and I encourage you to have them review the [REDACTED] if you have not already done so. 55

Thank you for the opportunity to comment. Please let me know if you have any questions, comments, or concerns.



SILO Notice
Green_redline.doc ..

Patrice -- please file in the Notices and Announcements Folder.

Susan L. Hartford

Office of Chief Counsel
Technical Advisor to the Special Counsel, NTA
CC:NTA Room 3045
(202) 622-[REDACTED] 56

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 11:12 AM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geler Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: RE: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Please provide your comments on the guidance described below to George Blaine and John Aramburu. Thank you.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED] 56

-----Original Message-----

From: Crisalli Donna M
Sent: Friday, December 10, 2004 2:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geler Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M

Cc:
Subject:

Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

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<< File: SILO Notice Green 12-10-04.doc >> << File: SILO Notice Executive Summary .doc >>

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-██████

b6

Aramburu John M

From: Arndt Melissa D
Sent: Wednesday, December 15, 2004 9:17 AM
To: Blaine George J; Aramburu John M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Additional SILO comments from LMSB.

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

-----Original Message-----

From: Wolfe Rebecca W
Sent: Tuesday, December 14, 2004 6:19 PM
To: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Mike Winters' comments.

-----Original Message-----

From: Robbins Kathy J [<mailto:Kathy.J.Robbins@irs.gov>]
Sent: Tuesday, December 14, 2004 4:51 PM
To: Wolfe Rebecca W
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Kathy.J.Robbins@irs.gov
Executive Assistant, Natural Resources & Construction
1919 Smith Street, MS 1000-HOU
Houston, TX 77002
713/209- 713/209-3723 Fax

-----Original Message-----

From: Winters Michael A
Sent: Tuesday, December 14, 2004 4:45 PM
To: Robbins Kathy J
Cc: Rea Oscar P
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Kathy, I have the following comment on this draft.

[REDACTED]

Michael A. Winters
Senior Technical Coordinator
Quality Measurement Staff
SB/SE Tech Services

Gulf States Territory
Houston, Mail Stop 4020 HOU

-----Original Message-----

From: Robbins Kathy J
Sent: Monday, December 13, 2004 7:41 AM
To: Winters Michael A
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Kathy.J.Robbins@irs.gov

Executive Assistant, Natural Resources & Construction
1919 Smith Street, MS 1000-HOU
Houston, TX 77002
713/209- [REDACTED] 713/209-3723 Fax

b6

-----Original Message-----

From: Wolfe Rebecca W [<mailto:Rebecca.W.Wolfe@IRSCOUNSEL.TREAS.GOV>]
Sent: Friday, December 10, 2004 3:49 PM
To: &LM Area 4 MGRS; Robbins Kathy J
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Please send me your comments, if any, by noon Thursday, December 16.

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

THE ATTACHED DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE. YOU ARE HEREBY NOTIFIED THAT ANY DISCLOSURE, COPYING, OR DISTRIBUTION, OR THE TAKING OF ANY ACTION IN RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS OFFICIAL POSITIONS OF THE IRS.

<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-[REDACTED]
Fax: (202) 283-7176

b6

Aramburu John M

From: Arndt Melissa D
Sent: Friday, December 17, 2004 9:47 AM
To: Blaine George J; Aramburu John M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Additional comments on the SILO notice from LMSB.

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

-----Original Message-----

From: Liberator Amy [<mailto:Amy.Liberator@irs.gov>]
Sent: Friday, December 17, 2004 9:42 AM
To: Arndt Melissa D
Cc: Zelnik Jonathan R; Allen Cary D; Autry Patricia J; Snyder Robert; Claybough Cheryl P
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

I like the additions that were made to the Notice and have the following comments:

b5

Thanks for seeking our input. Have a great weekend!

Amy Liberator
Technical Advisor - Leasing
2 South Main St. Room 395 Akron, OH 44308
Phone: 330-253-
Fax: 330-253-7232
Visit the Leasing TA Website at: <http://lmsb.irs.gov/hq/pftg/leasing/index.asp>

b6

-----Original Message-----

From: O'Donnell Douglas W
Sent: Friday, December 10, 2004 4:29 PM
To: Claybough Cheryl P
Cc: DeNard Paul D; Allen Cary D; Autry Patricia J; Liberator Amy
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Cheryl,

Please share as appropriate. Comments are necessary in one week.

Douglas W. O'Donnell
Deputy Director Pre-Filing & Technical Guidance
Washington, DC
202.283. [REDACTED] (Phone)
[REDACTED] (Cell)

b6

-----Original Message-----

From: Arndt Melissa D [mailto:Melissa.D.Arndt@irscounsel.treas.gov]
Sent: Friday, December 10, 2004 4:27 PM
To: &LM PG Crc; &LM Shelters
Subject: CIRC. - SILO Listing Notice - 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

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SILO Notice Green
12-10-04.doc...

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283- [REDACTED]
Fax: (202) 283-7176

b6

Aramburu John M

From: O'Donnell Douglas W [Douglas.W.O'Donnell@irs.gov]
Sent: Monday, December 13, 2004 7:42 AM
To: Arndt Melissa D
Cc: Claybough Cheryl P
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

I am not familiar with the level of detail to which Cary's suggestions delve, but I think this should be shared.

Thanks,

Douglas W. O'Donnell
Deputy Director Pre-Filing & Technical Guidance
Washington, DC
202.283. (Phone)
(Cell)

b6

-----Original Message-----

From: Allen Cary D
Sent: Monday, December 13, 2004 1:21 AM
To: Claybough Cheryl P
Cc: O'Donnell Douglas W
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Attached is an e-mail I sent earlier this year with regard to t

b5

I have taken the draft Notice and

Please review this and forward it on as you see is needed.

CDA



SILO Notice Green
12-10-04 CDA...

-----Original Message-----

From: O'Donnell Douglas W
Sent: Friday, December 10, 2004 4:29 PM
To: Claybough Cheryl P
Cc: DeNard Paul D; Allen Cary D; Autry Patricia J; Liberator Amy
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Cheryl,

Please share as appropriate. Comments are necessary in one week.

Douglas W. O'Donnell
Deputy Director Pre-Filing & Technical Guidance

Washington, DC
202.283. (Phone)
(Cell)

56

-----Original Message-----

From: Arndt Melissa D [mailto:Melissa.D.Arndt@irs.counsel.treas.gov]
Sent: Friday, December 10, 2004 4:27 PM
To: &LM PG Crc; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

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<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

Aramburu John M

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu, John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

b6

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?



FW: CIRC. -- SILO
Listing Not...

Thanks,

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283- [REDACTED]
Fax: (202) 283-7176

b6

[REDACTED]

b5

-----Original Message-----

From: McClanahan III Frank C
Sent: Monday, December 13, 2004 8:40 AM
To: Arndt Melissa D
Cc: Dow Harmon B
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

MAC

-----Original Message-----

From: Dow Harmon B
Sent: Friday, December 10, 2004 4:25 PM
To: William Merkle (Merkle William G); Benjamin De Luna (De Luna Benjamin A); Fried Clint M (Clint.M.Fried@IRSCOUNSEL.TREAS.GOV); Gannon Richard H (Richard.H.Gannon@IRSCOUNSEL.TREAS.GOV); James Lanning (James.C.Lanning@IRSCOUNSEL.TREAS.GOV); Pam Gibson V (Gibson Pam V); Reid Huey (Huey Reid M); Bob Shilliday Jr (Shilliday Robert Jr J); Steven Guest (Guest Steven R); Vicki Hyche (Hyche Vicki J); Rogelio Villagellu (Villagellu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahanII@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following techmis file:
2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

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SILO Notice Green
12-10-04.doc...

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

Aramburu John M

From: Young Donna Marie
Sent: Wednesday, December 15, 2004 4:29 PM
To: Aramburu John M
Cc: Ellison Christine E; Volungis Tara P
Subject: FW: Listing Notices

Follow Up Flag: Follow up
Flag Status: Flagged

John - see emails below, and the attached. We are ok with LMSB's proposed penalty change, with the exception noted below.

-----Original Message-----

From: Young Donna Marie
Sent: Wednesday, December 15, 2004 1:58 PM
To: Volungis Tara P; Ellison Christine E
Cc: Lay Matthew W; O'Shea William P
Subject: RE: Listing Notices

In addition to Tara's, I would add:

✓
✓
✓
I also agree with LMSB's proposed change to the boilerplate reference to [REDACTED] (see attached email). However, [REDACTED]

55



FW: CIRC. - SILO
Listing Noti...

I also forwarded the draft to Bill and Matt since they've been involved in SILO discussions before. I copied them on this email so they can see our comments.

OK

Let me know if you agree because John is waiting for me to respond to his email about LMSB's proposed change.

-----Original Message-----
From: Volungis Tara P
Sent: Friday, December 10, 2004 3:56 PM
To: Young Donna Marie; Ellison Christine E
Subject: RE: Listing Notices

55

-----Original Message-----

From: Young Donna Marie
Sent: Friday, December 10, 2004 1:32 PM
To: Volungis Tara P; Ellison Christine E
Subject: FW: Listing Notices

Comments ASAP, please.

-----Original Message-----

From: Aramburu John M
Sent: Friday, December 10, 2004 12:15 PM
To: Young Donna Marie
Subject: RE: Listing Notices

Donna, this project is taking off. We could circulate the greensheet today. Attached is the latest draft. I will have a WLI opened for PSI. I apologize for not copying you sooner. Thank you. --John.
<< File: SILO Notice 12-09-04.doc >>

-----Original Message-----

From: Young Donna Marie
Sent: Friday, December 03, 2004 2:20 PM
To: Aramburu John M
Subject: RE: Listing Notices

When the listing notice is ready, could we take a look at it? Then we'll need the WLI. Thanks.

-----Original Message-----

From: Aramburu John M
Sent: Friday, December 03, 2004 2:17 PM
To: Young Donna Marie
Subject: RE: Listing Notices

Donna,

Thank you so much. Please let me know if you want that WLI.

--John.

-----Original Message-----

From: Young Donna Marie
Sent: Friday, December 03, 2004 2:13 PM
To: Aramburu John M
Cc: Ackerman Jonathan - OTP
Subject: FW: Listing Notices

John - This boilerplate hasn't been approved yet, but here is what we sent to Treasury. << Message: boilerplate >>

-----Original Message-----

From: Young Donna M (NO)
Sent: Friday, December 03, 2004 2:08 PM
To: Young Donna Marie
Subject: FW: Listing Notices

-----Original Message-----

From: Aramburu John M
Sent: Friday, December 03, 2004 2:07 PM
To: Young Donna M (NO)
Subject: Listing Notices

Donna,

Could you look over the following and let me know whether this is appropriate language to insert in a Notice listing a transaction for purposes of the reportable transaction rules? My concern [REDACTED] b1
[REDACTED] If easier for you, you might email me the [REDACTED]
[REDACTED]. I apologize but need your assistance as soon as possible and will arrange to have a WCL opened if you wish.

Thank you.

[REDACTED] b5

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED]

b6

O'Connor David F P

From: Zelnik Jonathan R
Sent: Wednesday, December 01, 2004 12:07 PM
To: O'Connor David F P
Subject: FW: SILO Notice



SILO Notice
2004-11-18.doc (59...

-----Original Message-----

From: Jonathan.Ackerman@do.treas.gov [mailto:Jonathan.Ackerman@do.treas.gov]
Sent: Wednesday, December 01, 2004 11:55 AM
To: Jonathan.R.Zelnik@IRSCOUNSEL.TREAS.GOV
Subject: SILO Notice

Jon-

Attached is the draft I previously sent to Helen. This drafts incorporates suggested changes to address: (1) the [REDACTED] (2) John A.'s [REDACTED] and (3) Cary's [REDACTED]

Let me know if you have any questions/concerns.

Jon

Aramburu John M

From: Mirabito Diane R
Sent: Monday, January 03, 2005 2:53 PM
To: Arndt Melissa D
Cc: Zelnik Jonathan R; Aramburu John M; Graziano Peter J; Tancer Jody S; Dunnigan Abigail Foster; Kerrigan Thomas J; Mirabito Diane R; Snyder Robert; Allen Cary D; Autry Patricia J; Liberator Amy
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa-Industry Counsel has these comments on the revised draft below:

65

Please let me know if you have any questions on these comments. Diane

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 20, 2004 3:53 PM
To: &LM All IP; &LM Shelters; Allen Cary D; McClanahan III Frank C; Mirabito Diane R; Liberator Amy; Winters Michael A; Petronchak Kathy K; O'Donnell Douglas W; Grimm Danielle M; Arndt Melissa D
Cc: LaBelle Peter J; Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Attached is a revised draft of the SILO Notice showing changes from the green sheet copy.

<< File: SILO Notice Clearance 12-20-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

-----Original Message-----

From: Aramburu John M
Sent: Monday, December 20, 2004 1:46 PM

- To: Crisalli Donna M; Arndt Melissa D
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

Thanks to all who commented. I am responding to your request that we notify you of how the comments were handled.

9

35

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

36

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M

Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?

<< Message: FW: CIRC. -- SILO Listing Notice -- 12/18/04 >> Thanks,

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

-----Original Message-----

From: McClanahan III Frank C
Sent: Monday, December 13, 2004 8:40 AM
To: Arndt Melissa D
Cc: Dow Harmon B
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

MAC

-----Original Message-----

From: Dow Harmon B
Sent: Friday, December 10, 2004 4:25 PM
To: William Merkle (Merkle William G); Benjamin De Luna (De Luna Benjamin A); Fried Clint M (Clint.M.Fried@IRSCOUNSEL.TREAS.GOV); Gannon Richard H (Richard.H.Gannon@IRSCOUNSEL.TREAS.GOV); James Lanning (James.C.Lanning@IRSCOUNSEL.TREAS.GOV); Pam Gibson V (Gibson Pam V); Reid Huey (Huey Reid M); Bob Shilliday Jr (Shilliday Robert Jr J); Steven Guest (Guest Steven R); Vicki Hyche (Hyche Vicki J); Rogelio Villageliu (Villageliu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahanIII@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following techmis file:
2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

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<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

66

Aramburu John M

From: Crisalli Donna M
Sent: Wednesday, January 19, 2005 12:36 PM
To: Ackerman Jonathan - OTP
Cc: Hubbard Helen - OTP; Blaine George J; Zelnik Jonathan R; O'Connor David F P; Aramburu John M; Ashford Tamara W; Fahey Douglas A
Subject: RE: SILO listing notice

The cite to the [REDACTED] 4.

b5

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED]

-----Original Message-----

From: Crisalli Donna M
Sent: Wednesday, January 19, 2005 9:51 AM
To: Ackerman Jonathan - OTP
Cc: Hubbard Helen - OTP; Blaine George J; Zelnik Jonathan R; O'Connor David F P; Aramburu John M
Subject: FW: SILO listing notice

The Commissioner has approved this guidance with the addition of [REDACTED]
(as described in Tamara's email of Jan. 14, below). [REDACTED]
[REDACTED] by Treasury and has a notice number.

b5

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED]

b6

-----Original Message-----

From: Ashford Tamara W [mailto:Tamara.W.Ashford@irs.gov]
Sent: Wednesday, January 19, 2005 9:16 AM
To: Crisalli Donna M; Ashford Tamara W
Cc: Aramburu John M; Blaine George J; Zelnik Jonathan R; O'Connor David F P
Subject: RE: SILO listing notice

Hi Donna, great. With an added c [REDACTED] I am clearing this notice on behalf of the Commissioner.

(Based on emails this morning, I believe Treasury has approved the [REDACTED] by the way.)

b5

Thanks!

2/14/2005

Tamara

Tamara W. Ashford
Assistant to the Commissioner
202-622-[REDACTED] (office)
[REDACTED] (cell)
202-622-5552 (fax)
tamara.w.ashford@irs.gov

-----Original Message-----

From: Crisalli Donna M [<mailto:Donna.M.Crisalli@irs.counsel.treas.gov>]
Sent: Wednesday, January 19, 2005 9:10 AM
To: Ashford Tamara W
Cc: Aramburu John M; Blaine George J; Zelnik Jonathan R; O'Connor David F P
Subject: FW: SILO listing notice

Tamara, we will add [REDACTED] We've been in touch with APJP--they are still waiting for Treasury approval. We are working with Media Relations on a press release. b5

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED]

-----Original Message-----

From: Ashford Tamara W [<mailto:Tamara.W.Ashford@irs.gov>]
Sent: Friday, January 14, 2005 3:46 PM
To: Crisalli Donna M; Aramburu John M; Ashford Tamara W
Cc: Zelnik Jonathan R; Blaine George J
Subject: RE: SILO listing notice

Yes, if you all can contact Terry (Lemons) and Bruce (Friedland) in Media Affairs to put things in motion on the press release front that would be good.

[REDACTED] (drafted by P&A) will provide [REDACTED] (Attached is the version of [REDACTED]) b5

Tamara W. Ashford
Assistant to the Commissioner
202-622-[REDACTED] (office)
[REDACTED] (cell)
202-622-5552 (fax)
tamara.w.ashford@irs.gov

-----Original Message-----

2/14/2005

From: Ashford Tamara W [mailto:Tamara.W.Ashford@irs.gov]
Sent: Friday, January 14, 2005 1:31 PM
To: Crisalli Donna M
Cc: Zelnik Jonathan R; Ashford Tamara W
Subject: SILO listing notice

Hi Donna, this basically looks fine but one question and one (minor, non-substantive) suggestion:

1) What are we doing in terms of the collateral pieces to this notice – i.e., press release, etc? Is there a draft, and if so, can you forward it to me?

2) At the end of [REDACTED] very shortly (it will certainly be before publication of this SILO notice).

b5

Thanks!

Tamara

Tamara W. Ashford
Assistant to the Commissioner
202-622-XXXX (office)
[REDACTED] (cell)
202-622-5552 (fax)
tamara.w.ashford@irs.gov

b6



Case Closing Routing Form

Internal Revenue Service - Office of Chief Counsel

SEND TO:	Symbols	Room & Bldg	Action(s) - Initials - Date
Secretary	CC:ITA:		Case closing
Control Clerk	CC:ITA	4516	Case closing BH 3/8/05
File Room	CC:PA: LPD:DRU	5336	Case closing

NAME OF CASE: SILO Listing Notice
CASE MIS/WLI No.: NOT-157892-04
TARGET DATE:

SECTION 6110: No.
CLOSING STATUS: 980
CLOSING DATE: February 28, 2005

REMARKS:

FROM: John Aramburo
Symbols: CC:ITA: 5 Phone/FAX: 202 622 7710
Date Sent: 03-04-05 Room/Bldg: Main IRS Room 4237

CASE MIS (ICCHMIS REV RULING PROCEDURES DETAIL)

File Edit Action Navigate Option Window Help

Case Processing Add Case Quick Query Cross References Time Reporting Human Resources Reports

Project	
Case ID	NOTES/55241
Name	SILO LISTING NOTICE
Source	
Publication Number	2005-13
Publication Date	02/28/2005
RB Number	2005-9
Old ID	
Business Plan	Y
Reason Code	0
Total Cases	64/75
Workload Item	
Workload Type	PRI
Organization	BRANCH 5
Category	PUB GUID
Sub Category	NOTES
Status	951
Status Narrative	
Employee	MARAMB1
Reviewer	GJBLANI
Organization Received Date	11/04/2004
Branch Received Date	11/05/2004
Branch Target Date	
File Class	A
Issues	1
Remarks	0
Workload Item Hours	1/2
View Summary Add Related Apply Cancel	

This is the first record.

Record: 1/6

CASE MIS (TECHMIS REV RULING PROCEDURES DETAIL)

File Edit Action Navigate Option Window Help

Case Processing

Add Case

Case History

Cross Reference

Time Reporting

Human Resources

Reports

Case Details: Project: F. J. ...

Project

Case ID: NOTEL51892-01 Title: SILO LISTING NOTICE

Source

Publication Number

Publication Date

Entry/Release Date

RB Number

Non-Work Case Reason

Old ID

Business Process: ...

Workload Item

Workload Type

Add

Workload Item

Organization

COLLEGE

DIVISION OF COUNSEL/ASSOCIATE

Category

PUBLIC

Published Substance

Entry

Sub Category

NOT

Notice/Announcement

Category

12/27/2001

Status

DO

Case Unassigned

Status Date

12/27/2001

Status Narrative

Employee

Reviewer

Organization Received Date

Branch Received Date

Branch Target Date

File Class

Issues

View Summary

Add Related

Print

Cancel

OK

Close

Official IRS symbols for the organization. List of values available.

Record: 6/6

Start

Microsoft Outlook

CASE PROD ENVIRONME...

CASE MIS (TECHMIS R...

8:29 AM

Schwartz Edward C

From: DeNovio Nicholas J
Sent: Monday, July 28, 2003 4:07 PM
To: Schwartz Edward C
Cc: Jackson William A; Schwartz Edward C; O'Connor David F P; Brown Robert M; Zelnik Jonathan R; Lay Matthew W; Foster Abigail K
Subject: RE: SILO Summary

b3/
6103

[REDACTED]

b5

Perhaps only [REDACTED] but draw your own conclusion.

I think the issue we need to focus upon is [REDACTED] and what we can do at this time with a listing notice and a regulatory amendment if possible.

NJD

-----Original Message-----

From: Schwartz Edward C
Sent: Monday, July 28, 2003 3:53 PM
To: DeNovio Nicholas J
Subject: RE: SILO Summary

b5

Concerning number 4 below -- is that a [REDACTED]
[REDACTED]

-----Original Message-----

From: DeNovio Nicholas J
Sent: Monday, July 28, 2003 12:19 PM
To: Jackson William A; Schwartz Edward C; O'Connor David F P
Cc: Brown Robert M; Zelnik Jonathan R; Lay Matthew W; Foster Abigail K
Subject: SILO Summary

b3/6103
b5

Schwartz Edward C

From: Schwartz Edward C
Sent: Thursday, August 07, 2003 1:39 PM
To: DeNovio Nicholas J
Cc: Jackson William A; O'Connor David F P; Lay Matthew W; Brown Robert M
Subject: RE: SILO [REDACTED]

b5

That would be greatly appreciated. Addendum to my earlier e-mail: [REDACTED] is also very helpful to addressing the transaction under review. Thank you – Ed

b5

-----Original Message-----

From: DeNovio Nicholas J
Sent: Thursday, August 07, 2003 1:31 PM
To: Schwartz Edward C
Cc: Jackson William A; O'Connor David F P; Lay Matthew W; Brown Robert M
Subject: RE: SILO [REDACTED] materials

Thanks Ed; I am out beginning later today until the 18th.

Propose that we get together soon after my return.

NJD

-----Original Message-----

From: Schwartz Edward C
Sent: Thursday, August 07, 2003 1:16 PM
To: DeNovio Nicholas J
Cc: Jackson William A; O'Connor David F P
Subject: SILO [REDACTED] materials

b5

b6

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HEADLINE: #26 2003 TNT 126-26 LILOs AMD LEASE/SERVICE CONTRACT TRANSACTIONS:
A RESPONSE. (Release Date: JUNE 30, 2003) (Doc 2003-15585 (7 original pages))

ABSTRACT: William A. Macan IV, Allen & Overy, New York, critiques an article by Lee Sheppard on LILO and lease service transactions.

SUMMARY:

Published by Tax Analysts™

William A. Macan IV, Allen & Overy, New York, critiques an article by Lee Sheppard on LILO and lease service transactions.

AUTHOR: Macan, William A., IV
Allen & Overy

GEOGRAPHIC: United States

REFERENCES:

Subject Area:

- Corporate taxation;
- Leasing tax issues;
- Multijurisdictional taxation;
- Tax policy issues;
- Tax system administration issues

Cross Reference:

Lee A. Sheppard, "Challenging LILOs and Their Successors,"
Tax Notes, May 26, 2003, p. p. 1134.

TEXT:

Release Date: JUNE 30, 2003

Published by Tax Analysts™

LILOs and Lease/Service Contract Transactions:

A Response

By William A. Macan IV

William A. Macan IV is a partner in the New York office of Allen & Overy.

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* * * * *

Lee Sheppard recently offered, in "Challenging LILOs and Their Successors," Tax Notes, May 26, 2003, p. 1134 (the article), a purported analysis of the deficiencies of two techniques that have dominated U.S. cross-border leasing over the last 10 years -- the LILO transaction/^{1/} and the lease-to-service contract transaction. The article, with Ms. Sheppard's customary rhetorical flourishes,^{2/} alleges a few fatal flaws in these transactions and makes a number of other incorrect statements. Much of the article reflects similar assertions made in Revenue Ruling 2002-69;^{3/} none of them should be left to stand as though accurate.

By way of background, two principles of U.S. tax law, as it has developed over the years, underlie modern lease planning. First, a lessor, under even a triple net lease, will be deemed the owner of the leased property if it has a significant equity investment and maintains a significant interest in the property's "residual value" -- that is, the opportunity to enjoy significant value in the property when the lease is over, coupled with the risk that that value will not be realized.^{4/} Second, a lessor (like other property owners) will be deemed the obligor on indebtedness secured by its property even if it lacks personal liability therefor, provided it has a substantial "equity" in the property that will be protected and realized if the debt is paid off; in such a case, the lessor is viewed as the owner of the entire property, including the portion financed by the nonrecourse loan. These principles are part of the bedrock of tax common law^{5/} and provide the basis for both the LILO and the lease/service contract transactions the article addresses -- as well, of course, as the traditional leverage lease as it has been used over the last 40 years to provide financing for hundreds of billions of dollars worth of assets, domestic and foreign.

The article levels several charges:

1. "Collar" considerations presented by the lessee's alternative end-of-term options deprive the U.S. lessor of an interest in the residual and, therefore, of tax ownership of the property -- both in the LILO transaction (where the "property" is the head leasehold interest in the physical asset) and in the lease-to-service contract transaction (where the property is the physical asset itself).
2. In the LILO, the head lease and the sublease cancel each other out during their coextensive terms, leaving the U.S. lessor with only a future interest in the property (and, therefore, no tax-recognized debt obligation).^{6/}
3. Regulations promulgated in 1996 require that the term of the service contract be added to the term of the lease for purposes of computing "Pickle" depreciation.
4. The service contract option provided the lessee in the lease/service contract arrangement is not a viable alternative, so that the transaction lacks true lease status and the lessor

lacks tax ownership.

The first assertion demonstrates a basic misunderstanding of the law and facts. The second fails to recognize both the substantial difference in the nature of the LIFO's head lease and leaseback interests and, equally important, the similarity of the interests held by the U.S. participant in the LIFO and in the traditional and well-established sale-leaseback transaction. The third reflects a lack of understanding and appreciation of the context of the Pickle rules and the origin of the modern service contract concept. The fourth is an uninformed factual assertion made with no apparent effort to understand the market, which contradicts the considered opinions, based on substantial research and analysis of business, engineering, environmental, and appraisal experts, of the transaction participants.

1. 'Collar' -- Unbuttoned? The assertion with the broadest scope is that the alternatives provided to the lessee at the expiration of the initial user lease term, in either type of transaction, "collar" the leased asset or its value in a manner that deprives the lessor of a residual interest sufficient to support its tax ownership. This assertion, made several times in the article, misconceives the concept of collar as used in applicable case law, with its marked distinction from the arrangement the leasing transactions present, and misapplies it as well.

The classic leasing situation to which the collar concept and analysis are applicable is presented in Revenue Ruling 72-543.⁷⁷ That ruling describes a 21-year net lease of a vessel by S to X, which affords X the option, exercisable on the ninth anniversary of the lease commencement date, to purchase the vessel from S for a fixed price and affords S the option, exercisable on the same date, to sell the vessel to X at the same price. The ruling concludes that on these facts X has all the benefits and burdens of ownership, so that the arrangement constitutes for tax purposes a debt financing rather than a "true" sale-leaseback. The conclusion is correct and the reason is obvious: X has current possession and responsibility for the vessel and the entire risk of loss and opportunity for gain for the residual; whatever the value of the vessel in year 9, it will be advantageous either for X to call the vessel at the option price or for S to put it to X at that price, so that S's role (assuming no lessee default) is merely to receive, in all events, a series of fixed periodic payments and a predetermined final payment, all unaffected by the vessel's value -- a classic lender's position. Absent some new and different agreement between the parties, X will have sole possession and inevitably end up with ownership of the vessel.

Revenue Ruling 72-543 is not quite a collar case, since S's downside risk and upside potential are both zero, so that "collar" has no opening; but it sets the stage. The collar issue arises when differences are introduced in the terms of the put and call -- either the strike price, the exercise date, or both. Consider the case where the put price is 50 percent lower than the call price (and assume, for simplicity, that as of the transaction commencement date, estimated fair market value at exercise lies halfway in between). In this case, both the lessor's upside interest in the asset's residual value and its downside are constrained, "collared," compared to what they would be in the absence of both options: The lessor can be expected to exercise its put if the asset is worth at least 25 percent less than anticipated; the lessee will call if its value is at least 25 percent more than anticipated. However, if the asset's value falls in between, a strong likelihood given the closing date estimate, neither party will have the incentive to deprive the lessor of ownership; on these facts the collar is not very tight and should not be viewed as shifting tax ownership to the lessee or otherwise taking tax ownership from the lessor.

On the other hand, as the gap between the put and call prices narrows, the odds increase that one party or the other will be economically incented to exercise its option (and the amount the lessor can expect to take from the transaction becomes less variable). At some point short of the identity of price, the sale of the asset pursuant to one option or the other becomes sufficiently likely to conclude that the "lessee" has the principal benefits and burdens of ownership, and eventually the asset itself, and that the "lessor" can realistically

expect to receive only a relatively fixed amount of money from the transaction./8/

The Kwiat case described in the article/9/ does not present a "collar," so much as a noose. In that case the lessors had the right to put the leased property to the lessee for \$ 238,910 any time between October 13, 1985, and December 31, 1986; and the lessee had the right to call the property from the lessor for \$ 159,452 at any time between November 13, 1987, and December 31, 1987. On these facts, the Tax Court concluded that the benefits and burdens of ownership of the property shifted to the lessee on the commencement of the lease. This conclusion is even less remarkable than that of Revenue Ruling 72-543: As of December 31, 1986, the lessors, if they had not by then exercised their put, would be economically compelled to do so, no matter what the value of the property. By exercise, they would receive almost \$ 240,000; if they did not exercise they were effectively guaranteed to receive less -- \$ 160,000 if the lessee exercised its call, or even less if the value of the property during the call exercise period was less./10/ In this case the Kwiat's interest in the "residual" was not collared; it was effectively fixed at \$ 238,910, regardless of the property's actual value.

Revenue Ruling 2002-69 presents the facts of a not atypical LILLO transaction -- 40-year head lease term; 20-year sublease term; end-of-sublease term purchase option in sublessee, exercisable at 105 percent of estimated fair market value; if purchase option not exercised, sublessor could lease property to sublessee for an additional term of 10 years at rent set at 90 percent of the estimated fair rental value. The article describes the ruling's observation that the sublessee's end-of-term alternatives "operate to 'collar' the value of the head lease residual during the initial sublease term." It bemoans the ruling's failure to explain the significance of that fact and then proceeds to get it entirely wrong.

First, the Article states that the ruling "posits a tight collar." From this it concludes that the collar "either eliminates, or renders economically insignificant," any interest of the U.S. lessor in the residual value of its leasehold interest./11/ However, the ruling "posits" nothing of the sort; it merely describes the purchase option price and put renewal rents, without qualitative adjectives. In fact, the arrangement did limit the U.S. lessor's upside interest in the residual, as of year 20, at 105 percent of anticipated value, and it also limited the U.S. lessor's downside exposure in the property to some extent by requiring the sublessee in effect to provide a limited rental guarantee, at 90 percent of expected rental value. Even a true "collar" with these numbers (that is, involving a right to sell at 90 percent of expected sales value) would be nowhere near as tight, from one perspective, as the "collar" found not to effect a transfer of ownership in Penn-Dixie./12/ There is no indication, in case law or otherwise, that a "collar" around an asset's value equal to 15 percent of expected value is so "tight" as to cause the property owner to lack the benefits and burdens of ownership./13/ Wishing, as the article seems to do, doesn't make it so.

However, the article's treatment of this point suffers a much more serious -- indeed, fatal -- flaw. In Kwiat, as in Penn-Dixie and Revenue Ruling 72-543, the effect of the "collar" was to cause a transfer of the property from one person to another at a more or less fixed price; under those circumstances, if either option was exercised, the lessor would never have a serious interest in the property's residual value or, indeed, the property itself. The nature of the "collaring" features of the LILLO considered in Revenue Ruling 2002-69 is fundamentally different: If the property is worth what is anticipated, or less, the U.S. lessor will probably cause it to be leased to the lessee for another 10 years after which the U.S. lessor will have the same risk of loss in respect of its leasehold interest as the lessor in a "plain vanilla" 30 year lease of 40-year-lived property!

The fact (actually, the law) is that under U.S. tax leasing principles, a lessor's upside and downside interest in property can be substantially restricted -- effectively eliminated -- for a substantial period of time; if that interest is unfettered for a following period at least equal to 20 percent of the property's estimated useful life the IRS will rule that the lessor is the

property's tax owner./14/ The facts considered in Revenue Ruling 2002-69 (which in this regard are typical of most LILO transactions actually closed) present no more impingement on the U.S. lessor's interest in the residual than would a transaction in which the property is leased for a single term equal to 75 percent of its estimated useful life, with the lessee having an "early buyout option" (EBO), exercisable in year 20 at a price in excess of fair market value. Indeed, in the present case the U.S. lessor's interest is somewhat greater -- the ability to enjoy market rents in the last 10 years of the "lease term" higher than the guaranteed minimum, so long as they do not increase the property's (or, in this case, the leasehold's) value above the EBO purchase price.

The article cites the ruling's failure to make something of its observation regarding "collared" value as a "huge failing,"/15/ but it was no such thing. The ruling made other errors, but that was not one of them.

The article makes essentially the same collar argument in connection with the lease/service contract arrangement. In that case, of course, the transaction gives the U.S. lessor tax ownership of the property, and sometimes title, but issues regarding the residual are the same as those presented by the LILO. In this type of transaction, the property is purchased by the U.S. lessor and leased for a single, nonrenewable term; at the end of that term the lessee may either purchase the property at a fixed price (generally set, as in the LILO, at above expected fair market value) or arrange for the property to become subject to a service contract arrangement. The details of the service contract concept and how it, and transactions providing for it, differ from a renewal or replacement lease are briefly described below. For present purposes it is sufficient to note that one element of the required service contract is that it provide the property's owner with a relatively assured source of funds (during a term that does not extend beyond 80 percent to 85 percent of the property's estimated useful life) sufficient to repay the lessor's loans and its equity investment.

The article states, "[T]he combination of the put option [actually the lessee's purchase option] and the service contract [requirement] has the economic effect of a collar on the residual value of the property." This statement is true in the same sense as the similar statement in Revenue Ruling 2002-69 is true: As of the end of the (relatively short) lease term the lessee may purchase the property, cutting off the lessor's right to receive property value, if any, in excess of the option price; or it must put a service contract arrangement in place (for a period not extending beyond 80 percent of the property's estimated useful life) that provides (assuming it is performed without default) a minimum return to the (former) lessor.

The article goes on to assert, "The last thing that the . . . lessor wants is the risk of ownership of the property, so this collar takes it off the lessor and puts it on the lessee." The factual basis for this allegation is totally obscure. How Ms. Sheppard knows what the lessor wants is not explained, but the first thing the lessor will get, if the service contract arrangement is put in place, is much more of the ownership aspects of the property than attends the normal lessor position. While a minimum financial return is provided for, it is not assured (as contrasted with a hell-or-high-water net lease rent obligation); the nature of the service contract imposes on the lessor and its agents much more involvement with and responsibility for the property than would a lease. If one accepts that putting the service contract arrangement in place is a viable alternative to purchase option exercise, about which more below, then the factual basis for the argument that collar considerations deprive the lease/service contract arrangement of "true lease/tax ownership" status is even less present than in the case of the LILO.

2. 'Canceled' Check -- The article's second assault on the LILO is a regurgitation of the argument made in Revenue Ruling 2002-69: that the head lease interest provided to the U.S. lessor and the leasehold interest granted by the U.S. lessor back to the property's legal owner are of the "same nature" and "cancel" each other out during the term of the

leaseback, such that the transaction creates nothing until the expiration date of the lease. A bit of checking into the facts indicates that this easy melding doesn't wash.

In the typical LILO transaction, the U.S. lessor's head leasehold interest is effectively without condition, except for the condition of paying rent; since the prepayment covers all rent due under the head lease, or at least all rent that will be payable during the term of the leaseback./16/ the U.S. investor essentially cannot be ejected from its position in the property./17/ By contrast, the lessee's continued possession and use of the property is subject to a myriad of conditions -- for example, payment of periodic rent, satisfaction of the usual panoply of net lease obligations -- failure of which could lead to its ouster and the assumption of possession by the U.S. lessor or its designee./18/ That represents, I suggest, a substantial qualitative difference in the "nature" of the two leasehold interests./19/

Moreover, looking at the LILO from another perspective, it is difficult (actually, impossible in my view) to draw a meaningful distinction between the role of the U.S. lessor vis-a-vis its lessee in a classic sale-leaseback or other leveraged lease transaction and its role in a LILO. In both cases, the lessee has, for as long as it performs its obligations, the complete possession, control, and right of exploitation of, and responsibility for, the property. A fundamental "neutral principle" of U.S. income taxation, particularly tax common law, is that similarly situated taxpayers should be treated similarly. The only basis I can discern that the article puts forth for distinguishing these two situations is the assertion that in the LILO "the asset is subtracted from the equation for analytical purposes," leaving only "two offsetting contractual obligations." But just as the obligations do not "offset," so the asset is not "subtracted"; the U.S. lessor acquires a long-term leasehold in the property that is as much an asset as outright ownership, albeit of a more limited nature./20/ Comdisco,/21/ as the article notes (with some anguish), does acknowledge the "lessee-sublessor" position of the party in the middle of a lease-sublease; it is difficult to see any logic in the assertion that the identity of the sublessee renders that position any less substantive.

In short, the facts of the LILO do not support any part of the article's argument against it./22/

3. Extra Pickle? -- The article correctly indicates that the objective of the lease/service contract arrangement is similar to that of the replacement lease transaction that had its heyday between 1989 and 1995 -- to combine a relatively short lease term, and the consequent limitation of the impact of the so-called Pickle rule applicable to "tax-exempt use property," with the tax-deferral economics of a longer-term transaction./23/ This is accomplished by a requirement that, if the lessee does not exercise its purchase option, it is required to put in place an arrangement under which the property is used to provide a service to one or more service recipients, for fees that include a capital cost component sufficient to satisfy the indebtedness on the property and return the lessor's equity investment with a meaningful return. As was the case with the replacement lease, the economic terms are set such that, if the property has the value at lease end estimated for it at lease inception the lessee will find it less expensive, economically, to effect the service contract arrangement than to exercise the purchase option.

The article (as do the facts) raises two issues regarding this technique: Does it in fact serve the purpose (that is, is it effective to limit the 125 percent calculation to the stated lease term); and does it present a viable alternative to purchase contract exercise? The article alleges that neither question can be answered affirmatively. Wrong again.

As the article notes, the 1996 regulations required to be included in the "lease term" any period if the lessee either "(i) has agreed . . . [to] be obligated to make a payment of rent or a payment in the nature of rent with respect to such period; or (ii) has assumed or retained any risk of loss for such period (including, for example, by holding a note secured by the property)." The first criterion is not relevant to the service contract arrangement. As outlined

below, the code draws a sharp distinction between a service contract and a lease -- so sharp that a service contract fee is neither rent nor in the nature of rent. The question does arise, however, whether the second criterion might be applicable.

When the investment tax credit was enacted in 1962, it was made unavailable for property leased to governmental units and tax-exempt organizations. However, almost from the beginning it was evident that property used to provide a service to such an entity was not disqualified, as long as the relationship between the property owner and the exempt entity could be characterized as other than a lease. A number of revenue rulings were issued in the late 60s and 70s seeking to make the distinction;/24/ and a well-known case involving Xerox copiers used in U.S. government offices was decided favorably to the taxpayer./25/

The enactment of energy tax credits in the early 80s increased the pressure to develop service contract arrangements for various municipal assets, for example, trash-to-energy facilities. This pressure was intensified with the development of sentiment for the Pickle depreciation rule, withdrawing the benefits of accelerated depreciation from assets leased to tax-exempts. In the same legislation that enacted the Pickle rule (the Deficit Reduction Act of 1984) Congress provided, in what is now section 7701(e), a reasonably detailed set of criteria for distinguishing a service contract from a lease. These rules were adopted with the clear and indisputable intent that transactions that fell on the right side of the line they draw would be eligible for accelerated depreciation deductions (and investment credit), notwithstanding the involvement of a tax-exempt entity.

The first thing that comes out of this history is confirmation of the point made above -- that the statute demands a distinction between qualified service contract payments and "payments in the nature of rent." The second principle that emerges is that property subject to a service contract is not to be encumbered by depreciation limitations applicable to leased property. This necessarily means that to interpret the 1996 Pickle regulations to include a service contract in the 125 percent calculation cannot be permissible, since it would result in regulations being contrary to congressional intent, and therefore invalid. Properly read then, the "risk of loss" aspect of the Pickle regulations cannot go so far; instead, it should be limited to the type of situation that gave rise to the addition of this aspect to the 1995 proposed regulations -- the "lender of last resort" arrangement sometimes included in transactions whose economics required loan refinancing.

In light of this history, the article's easy assertion that proponents of the view expressed in the preceding paragraph "are reading the [risk of loss] provision out of the regulation" is easily seen as incorrect; we proponents are reading only an illegitimate interpretation of that provision out of the regulations.

4. Viability -- The article makes the serious charge, again with no cited factual support, that the service contract option does not present the lessee with a viable alternative at lease termination. If this charge were correct, then the lessee would be forced to exercise its purchase option in all events, without regard to the property's value, and the transaction would likely fail to qualify, from the outset, as a true lease./26/

This is not the place to get into the intricacies of what a service contract is or how it is distinguished under section 7701(e) and other relevant authorities, from a lease./27/ It is appropriate, however, to point out that the viability of a service contract arrangement for particular kinds of property and facilities -- in different jurisdictions at different times -- is not properly handled with a facile "ain't gonna happen."/28/ Lease investors and leasing tax planners make substantial investments of time and resources in determining whether and on what terms service contract arrangements may be both possible and viable for a particular transaction. Lawyers with the highest ethical standards and understanding of what is required by way of factual inquiry to render a proper opinion are doing so -- concluding both that the option afforded the lessee is one that can be performed and that, if performed, the

arrangement (the terms for which are usually established, with some degree of formality in the transaction documentation) will fall on the service contract side of the line drawn by or under section 7701(e).

U.S. lessors enter into these transactions with the understanding that, to be entitled to the tax treatment that is an important part of the investment decision, they must be able to demonstrate that the lessee's alternative to purchase option exercise is a realistic and commercially viable alternative, and that it would meet the requirements for a service contract./29/ Should they be unable to do so their transactions will fail.

As the article's title suggests, LILOs and lease/ service contract transactions are "challenging"; but they are not incomprehensible or, correctly planned and structured, improper or ineffective to accomplish their purpose. One may appropriately question (more easily, perhaps, with hindsight than as the issues evolved) whether the law should have developed such that a person without current possession, use, or responsibility for property should be treated as its owner or that one without personal liability for a loan should be treated as its borrower, and the owner of property acquired with, and securing, that loan. But as long as our law provides for these conclusions, as it does, one cannot fairly charge with impropriety taxpayers who use those conclusions to their advantage or judges who enforce them.

The leasing industry has probably kept quiet, or at least behind the scenes, too long in the face of the public attacks levied against it -- by administration officials and legislators, by the Internal Revenue Service, and by commentators providing the kind of slapdash, back-of-the-hand treatment reflected in the article that substitutes accusation and invective for analysis and fair-minded evaluation. Perhaps this defense will encourage others to speak up.

FOOTNOTES

/1/ One might have thought this part of the article somewhat out of date. As it eventually points out, adoption of the Section 467 regulations in 1999 implemented a rent-prepayment-equals-loan principle authorized by statute in 1984, that (as was long recognized it would) repealed the (longstanding, usually government-favorable) tax accounting regime on which LILO was based and put it out of business.

/2/ Examples (which probably do not promote careful evaluation of the issues): "pound-foolish," "hypersensitive" leasing bar, "foment collusion," "stupidest district court judges," "elusive service contractor," "checkered history," "ain't gonna happen," and "figment of the tax planner's imagination."

/3/ 2002-44 IRB 760, Doc 2002-23195 (13 original pages), 2002 TNT 199-1.

/4/ For planning purposes, the residual value requirement is usually satisfied, in compliance with IRS advance ruling guidelines (first issued in 1975 and reissued without change in 2001), by having a lease term no longer than 80 percent of the property's estimated useful life and an expected value for the property at lease expiration at least equal to 20 percent of value at lease commencement; case law imposes similar conceptual requirements but with smaller numbers. The classic leveraged lease transaction has these features, with the U.S. lessor making an equity investment of 13 percent to 25 percent of property cost (i.e., not infrequently less than the 20 percent required by the ruling guidelines but ample under case law), with the balance financed by nonrecourse debt expected to be satisfied out of lease rentals and property disposition proceeds, and the lessee afforded a fixed-price purchase option (at a price in excess of anticipated value) exercisable during, or at expiration of, the lease term. This latter feature is not authorized by the advance ruling guidelines, but its

consistency with true lease status is confirmed by cases too numerous to count. A recent Wall Street Journal article refers, with apparent astonishment, to a "shelter called SILO -- an acronym for Sale-In, Lease-Out -- . . . [which Treasury] officials have known about . . . for more than a year." (McKinnon and Harwood, "Democrats Push Crackdown on Corporate Tax Shelters," WSJ, June 6, 2003.) In fact, Treasury officials, among many others, have known of -- and approved -- sale-leaseback transactions for decades (although I for one had not heard the acronym before this article).

/5/ Underlying the extensive case law providing these principles are several U.S. Supreme Court decisions: Helvering v. F.&R. Lazarus & Co., 308 U.S. 252 (1939); Crane v. Commissioner, 331 U.S. 1 (1947); Frank Lyon Co. v. Commissioner, 435 U.S. 561 (1978).

/6/ The article, reflecting Revenue Ruling 2002-69, argues for disregard of the debt incurred by the U.S. lessor to fund a portion of its head lease rent prepayment on the basis that, because the head lease and leaseback do not exist, the loan proceeds acquire nothing and there is no source for loan repayment. Under this logic, in a transaction in which the "cancellation" analysis is inapplicable (a sale-leaseback or, as argued here, a lease-leaseback), the loan would be respected.

/7/ 1972-2 C.B. 87.

/8/ Penn-Dixie Steel Corp. v. Commissioner, 69 T.C. 837 (1978), illustrates the collar analysis in a nonleasing context, where the put and call exercise prices were identical but the exercise periods were different. In that case, on July 1, 1968, Continental and Union formed a corporation, Phoenix, each taking back one-half of its stock. At the same time they entered into two option agreements, one giving Union the right to put its Phoenix shares to Continental for, effectively, \$ 8.5 million at any time between August 1, 1970, and July 31, 1971; and the other giving Continental a call on Union's Phoenix shares at the same price, at any time between August 1, 1971, and July 31, 1972. Continental's successor, Penn-Dixie, argued that these option agreements (together with other funding arrangements entered into at or around the time of Phoenix's creation) effected a sale of Union's Phoenix shares to Continental as of July 1, 1968, arguing that "the possibility that the put or call would not be exercised was so remote that it should be ignored." The Tax Court, saying, "We consider it more than a remote possibility that Phoenix might so prosper in the first 3 years that Union would forego the exercise of its put and that the economic outlook for the steel industry could then change sufficiently in the following year to lead Continental to decide not to exercise its call," rejected Penn-Dixie's contention.

/9/ Kwiat v. Commissioner, T.C. Memo. 1992-433.

/10/ Even if one assumes that the intrinsic value of the property (warehouse racks installed on the lessee's premises) might, standing alone, be worth more than the put price on the expiration date of the put, the fact that it could be called 10 months later for two-thirds of the call price meant that the market would never deliver such a price on a third-party sale by the lessors; they could not afford not to exercise the put.

/11/ For purposes of understanding and analyzing the "collar" issue, in the context of the LILO and, even more importantly, in the context of the lease/service contract transaction, one must assume that the LILO transaction does create a real, substantial property interest in the U.S. lessor -- the leasehold estate under the head lease. Revenue Ruling 2002-69 and the article challenge this conclusion, but that is a separate contention -- considered below. That challenge does not affect the article's assertion of the collar issue in connection with the lease/service contract or its inappropriateness in that context.

/12/ See note 8, *supra*.

/13/ The "Blue Book" prepared by the Staff of the Joint Committee on Taxation in connection with inter alia, the Taxpayer Relief Act of 1997's enactment of section 1259 (providing for "constructive sale" treatment for certain kinds of risk-limiting transactions involving "appreciated financial positions"), makes it fairly clear that a similar collar relating to a marketable security does not automatically result in "sale" treatment. General Explanation of Tax Legislation Enacted in 1997 177-78 (JCT Staff, Dec. 17, 1997).

/14/ Rev. Proc. 2001-28, 2001-1 C.B. 1156, Doc 2001-12729 (5 original pages), 2001 TNT 88-8. Case law requires less of an anticipated residual interest to find a true lease.

/15/ The article asserts that "the ruling should have said that the existence of the collar means that there is no true lease," but it provides no basis (other than citation of the distinguishable and wholly inapplicable Kwiat) for this conclusion.

/16/ Not every LILO transaction features the prepayment and "postpayment" of head lease rents described in the article and Revenue Ruling 2002-69. That structure, in fact, was the product of a rather silly rule contained in the proposed section 467 regulations (and continued in the final regulations) -- that a lease's allocation of rents would be respected if, but only if, the amount of rent paid equals the amount of rent allocated. (See Treas. reg. section 1.467-1(c)(2)(ii)(A)(2).) This means that any lease that provides for prepayment of stated rent, with an appropriate discount for early payment, will not have its rent structure respected unless the discount is reflected in a provision specifically designating it as interest, at best a trap for the unwary. Before the regulations' being finalized it was sometimes not desirable to characterize or treat the discount as interest; in such a case, the only way to have the allocation of the prepayment to appropriate lease periods respected was to provide for a corresponding postpayment, with interest again implicit, but not stated.

/17/ The head lease usually imposed typical net lease obligations on the U.S. lessor (e.g., for insurance, maintenance, lawful use, etc.), but these obligations were often deemed satisfied for the term of the leaseback, whether or not the lessee in fact performed its corresponding obligations under its lease or, indeed, whether or not the leaseback remained in effect.

/18/ Other conditions often included a limitation or prohibition on the lessee's ability to dispose of its interest in the property and to merge or otherwise reorganize, and a requirement to provide additional collateral if its financial position deteriorates. For the many lessees that have had to comply with requirements such as these, the assertion that their LILOs did nothing to change their positions is much more hollow than they would like. (It would not be difficult to find among LILO lessees dissenters from the group of "everyone" who, the article (with no data or other support) asserts, "can agree that in a LILO deal, nothing happens. . . .")

/19/ The Article cites two cases involving "offsetting debt obligations" in support of its assertion that the lease-leaseback must be disregarded. Rickey v. Commissioner, 502 F.2d 748 (9th Cir. 1974); Big D Development Corp. v. Commissioner, 30 T.C.M. 646 (1971), affirmed per curiam 453 F.2d 1365 (5th Cir. (1971)), cert. denied 406 U.S. 945 (1972). These cases are totally inapposite, involving as each does, mutual, ongoing reciprocal loan payment obligations; in the LILO the U.S. lessor has paid upfront everything it is obligated to pay during the period of the leaseback, and it has no reciprocal obligation against which to offset and "cancel" the lessee's lease rental obligation. The article's assertion that because the "head lessor and sublessee are the same party, . . . the head lessee/sublessor is not exposed to any risk that the sublessee will fail to pay rent" is just plain wrong. The article also cites Bussing v. Commissioner, 88 T.C. 449 (1987), apparently to argue that the "two-party" arrangement between the property owner and the U.S. lessor should be disregarded. (Since the article earlier cites the role of the lenders in the facts of Revenue Ruling 2002-69, one wonders where they went when the parties were being counted.) This citation too is inappropriate and ineffective to support any relevant point. Bussing disregarded the lessee

loan created in a purported sale-leaseback in the rather unique factual situation where the parties following closing, totally disregarded their purported transaction, paying neither rent nor debt service; and where the obligation to repay the loan was suspended when the rent was not being paid. It is clear that these facts were essential to the court's decision and its distinction of approved sale-leaseback cases such as Mukerji, 87 T.C. 968 (1986), and Estate of Thomas, 84 T.C. 412 (1985). By contrast, in the transactions with which the article and this response are concerned, the parties are dealing at arm's length, the transactions are real, and the parties do what the documents say and require that they do. Bussing is an inappropriate remedy.

/20/ The article makes several other statements whose relevance to the argument is obscure but that are too good to go unobserved. Citing Bussing, it says, "Two parties do not make a sale-leaseback; two parties foment collusion." One wonders just how many of the billions of two-party transactions (that occur every day) the article really wishes to tag with the appellation "fomented collusion." Elsewhere the article, apparently in an effort to show that the U.S. investor has no equity in the property or leasehold because (under the frayed collar analysis) it has no risk of loss, states, "A lender does not have the risk of loss of value of property securing the loan. If a person who has advanced funds to the possessor of the property has no risk of loss, the deal is a loan." Anyone who has ever lost money on a secured loan would likely disagree.

/21/ Comdisco, Inc. v. Commissioner, 756 F.2d 569 (7th Cir. 1985).

/22/ The article seems also to be concerned about the defeasance arrangements in the transaction, but it is not clear that they constitute an independent basis for its attack on LILOs (or lease/service contract arrangements). See note 6, *supra*. In any event, based on the authority of Treas. reg. section 1.61-13(b) and Rev. Rul. 85-42, 1985-1 C.B. 36, and supported by LTR 8804020, I am willing to admit, as charged by the article, to being "unfazed" by the economic defeasance arrangements featured in many LILOs and lease/service contract arrangements. I'll leave my explanation to another occasion. However, I do not, as the article suggests, "argue that there is no one at risk in a sale-leaseback transaction with purchase money debt, because the money flows in a circle"; and I doubt that there are many other "leasing specialists" who do either.

/23/ This rule (named for former Representative J.J. Pickle of Texas), which was enacted in 1984 and now appears as section 168(g)(3), requires property leased to a non-U.S. taxpayer to be depreciated (straight-line) over a recovery period of not less than 125 percent of the lease term. Regulations proposed in 1995 and adopted in 1996 require that the term of a "replacement lease" (a lease the lessee is required to arrange if it does not exercise its end-of-term purchase option) must be added to the term of the initial lease for purposes of the 125 percent calculation.

/24/ Rev. Rul. 68-109, 1968-1 C.B. 10; Rev. Rul. 71-397, 1971-2 C.B. 63; Rev. Rul. 72-407, 1972-2 C.B. 10.

/25/ Xerox Corporation v. United States, 656 F. 2d 659 (Ct. Cl. 1981).

/26/ The expectation, even the very strong likelihood, as determined at lease inception that a purchase option will be exercised is not fatal to true lease characterization. See, e.g., Transamerica Corp. v. United States, 15 Cl. Ct. 420 (Cl. Ct. 1988) (option to purchase, for price equal to between one year's and two years' rent, title plants that were the core of the lessee's title abstract business, did not invalidate true lease nature of the transaction). However, few planners are comfortable with the true lease conclusion where such exercise is compelled by the terms of the transaction itself. The most common example of an option resulting in non-true-lease treatment is one exercisable at a nominal amount; however, even where the option price is set at a substantial level (e.g., at or above anticipated market

value, as with typical big-ticket leasing transactions), if the lessee has no real option not to exercise the case is analytically indistinguishable from the nominal purchase option case.

/27/ See, e.g., Macan and Umbrecht, "Cross-Border Leasing: Pickles, FSCs and Double-Dips," Chapter 25 of Equipment Leasing -- Leveraged Leasing, (Practising Law Institute 1977, 1980, 1999, 2000, 2001, 2002, Ian Shrank and Arnold Gough eds.) at section 25:2.3[A].

/28/ In fact, a review of the financial and engineering press demonstrates that privatization of heretofore public functions is, around the world, the wave of the present. Indeed, the article itself demonstrates this awareness in stating, "there are contractors who might be willing to take over and run a utility, like an electric generator or a water treatment plant." Why then is this not likely to be the case with other "large public assets"?

/29/ Unlike the case of many tax "products" of the type that, much more readily than leasing, are vulnerable to the accusation of "abusive corporate tax shelter," leasing is not hidden or treated secretively. (The leasing community is sometimes amused at the lengths to which participants in other tax-oriented arrangements go to render them "nonconfidential" so as to avoid disclosure.) Big-ticket leasing participants have, since the confidential corporate tax shelter disclosure regulations were first issued in February 2000, complied massively, if with a distinct lack of enthusiasm (and reminders that compliance is being done as a protective measure only, without admission that it is required) with those regulations, registering almost every transaction with the IRS and making full disclosure on tax returns.

END OF FOOTNOTES

***** End of Document *****

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Schwartz Edward C

From: DeNovio Nicholas J
Sent: Wednesday, June 18, 2003 9:16 AM
To: Brown Robert M
Cc: Jackson William A; Schwartz Edward C; O'Connor David F P; Zelnik Jonathan R; Aramburu John M; Moffitt Thomas D
Subject: SILOs

Bob,

Thank you for assembling some of the top members of your team on Monday to discuss this very important subject. You may have seen the recent Lee Sheppard article on the topic and the WSJ article on corporate tax shelters, with a mention of this transaction in a misleading context which made it appear as if we were doing nothing. These factors along with the volume of cases being identified by LMSB means that we need to move quickly to analyze the transaction and come to a conclusion. Eric asked me yesterday what we were doing on SILOs.

Note that we have already contacted PSI, who informs us that Eileen Shatz will be its representative on the task force.

Yesterday afternoon we received [REDACTED]

[REDACTED]

b3/g103

I believe that we should proceed as follows:

1. First, could you make certain that all of the extensive information and materials with regard to the LILO task force work product is made available to your SILO team. It would likely be useful for the SILO team to meet and review the materials provided by David O'Connor to you on June 9, along with any other materials John Aramburu, who was a member of the LILO task force, thinks important. John - you

are aware of what work product from the prior task force would be important to your colleagues. [REDACTED] 55

[REDACTED]
[REDACTED]. We do not want to recreate this work product, but rather leverage what we have. Also, [REDACTED] 53
610

[REDACTED]
v [REDACTED] 55

2. By early next week we will determine how best to apportion the deal documents between our offices and perhaps LMSB Division Counsel, so that we can each review a separate deal and then discuss common or unique factors.

3. Your group may also want to review John Aramburu's November 1, 2002 memo on SILOs and the [REDACTED]

4. Other issues will need research and development for the SILO analysis, including:

a. [REDACTED]

b. [REDACTED]
[REDACTED]

c. [REDACTED]
[REDACTED],

d. [REDACTED]

Please let me know if you have questions or comments on this proposed action plan. We look

Schwartz Edward C

From: Aramburu John M
Sent: Friday, January 31, 2003 8:01 AM
To: Jackson William A; Schwartz Edward C
Subject: FW: Frank Lyon Factors & "Holding"

FYI

-----Original Message-----

From: O'Connor David F P
Sent: Thursday, January 30, 2003 3:08 PM
To: Aramburu John M
Subject: Frank Lyon Factors & "Holding"

John:



FYI, I am attaching a list I did for myself of the factors cited by the Supreme Court that seem to have been the basis for the Court's holding (which I have quoted).

Going through the points raised by the Court and applying them to what we are seeing in LILOs & SILOs, I find the following:

SS

Schwartz Edward C

From: O'Connor David F P
Sent: Wednesday, December 04, 2002 9:35 AM
To: Wilcox Gary B; Pugh Cary D; Stevens Matthew A; Jackson William A; Aramburu John M; Schwartz Edward C; Kerrigan Thomas J; Allen Cary D; Zelnik Jonathan R
Cc: Williams B John; Parker Emily A; Preston Arlene
Subject: FW: SILO Task Group

Please note that our organizational meeting for the SILO Task Force, from 3:00 PM until 5:00 PM EST on Friday, 12/6/2002 will be held in Room 3040 (Gary Wilcox's Conference Room). Those attending by phone can call in on the conference number, (202) 622-, and use access code  52

I am forwarding to you three e-mails dated 12/1/2002 from Cary Allen. The first appears below. The other two are entitled "Info on SILOS" and "TAMS, TEAMS, SAMS, etc." and will be forwarded separately.

Dave [Phone: (202) 622-] 56

-----Original Message-----

From: Allen Cary D [mailto:Cary.Allen@irs.gov]
Sent: Sunday, December 01, 2002 4:25 PM
To: O'Connor David F P
Cc: Prager JoAnn
Subject: SILO Task Group

Dave,

I was talking with another Technical Advisor last week about leasing activiites. She indicated that some  53
6103




Thanks!!!!

Cary Allen



53/6103

Knapp Nancy V

From: Grimm Danielle M
Sent: Tuesday, February 15, 2005 12:01 PM
To: &LM HQ Employees; &LM Shelters
Cc: Dever James P; Avazian Andrea D; Jallade Louis E; Misir Bisamber; Patel Debbie J; Desousa Brian J
Subject: SILO Listing Notice - 2/11/05



silo notice.RTF (33
KB)

You may have already seen this but thought it worth circulating.

A new listing notice was issued on Friday, 2/11/05 (Notice 2005-13) for transactions commonly referred to as SILOs.

*****017376*****

SEND TO: GRIMM, DANIELLE
IRS CHIEF COUNSEL
DEPARTMENT OF TREASURY IRS
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Notice 2005-13

Tax-Exempt Leasing Involving Defeasance

2005 IRB LEXIS 68; 2005-9 I.R.B. 1; Notice 2005-13

February 11, 2005

[*1]

February 28, 2005

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S.-taxpayer. FP is a tax-indifferent person that owns and uses certain property. n1 BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.
>FTNT>

n1 In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.>ENDFN>

[*2]

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy[*3] certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of \$105x and X makes a single payment of \$105x to FP. To fund the \$105x payment, X provides \$15x in equity and borrows \$81x from BK1 and \$9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any

given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance[*4] the acquisition of new assets. Upon receiving the \$105x purchase price payment, FP sets aside substantially all of the \$105x to satisfy its lease obligations. FP deposits \$81x with BK3 and \$9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the[*5] parties treat these amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a result, neither bank bears a significant risk of nonpayment. n2

>FTNT>

n2 The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.>ENDFN>

[*6]

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest \$9x of the \$105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease. n3 Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment [*7] under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining \$6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

>FTNT>

n3 The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating>ENDFN>

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined minimum capacity payments sufficient to provide[*8] X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option. Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract [*9] in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other [*10] credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option[*11] price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property[*12] to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair [*13] market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. *Gregory v. Helvering*, 293 U.S. 465 (1935). In *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978), the Supreme Court stated that "in applying the doctrine[*14] of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in *Frank Lyon* to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in *Frank Lyon* as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." *Frank Lyon*, 435 U.S. at 584. The Court subsequently relied on its approach in *Frank Lyon* to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. *Nebraska Dep't of Revenue v. Loewenstein*, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional[*15] owner, including "the benefits and burdens of ownership." *Coleman v. Commissioner*, 16 F.3d 821, 826 (7th Cir. 1994) (citing *Frank Lyon*, 435 U.S. at 582-84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in *Frank Lyon*.

First, in *Frank Lyon*, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the \$105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit[*16] with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining \$6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in *Frank Lyon*, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. *Frank Lyon*, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan [*17] balances or forfeiting its equity investment.

Third, in *Frank Lyon*, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the determination of tax ownership. See, e.g., *Swift Dodge v. Commissioner*, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations[*18] under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. See *Kwiat v. Commissioner*, T.C. Memo. 1992-433[*19] (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); see also *Aderholt Specialty Co. v. Commissioner*, T.C. Memo. 1985-491; Rev. Rul. 72-543, 1972-2 C.B. 87. In contrast, in *Frank Lyon*, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. See *Hilton v. Commissioner*, 74 T.C. 305 (1980), *aff'd*, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse[*20] debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. Cf. Rev. Rul. 2002-69, 2002-2 C.B. 760 (disregarded offsetting obligations in a LILO arrangement [*21] gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject

to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. See H. R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662-663 (2004). These amendments generally are effective for leases entered into after March 12, 2004. n4
>FTNT>

n4 Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.>ENDFN>

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released[*22] to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A. n5 Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.
>FTNT>

n5 Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005-11, 2005-7 I.R.B. 493.>ENDFN>

The Service and the Treasury Department recognize that some taxpayers may have filed [*23] tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu on (202) 622-4960 (not a toll-free call).

Knapp Nancy V

From: Arndt Melissa D
Sent: Wednesday, December 22, 2004 1:29 PM
To: &LM PG Circ
Cc: &LM Shelters
Subject: FW: SILO Notice

FYI

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

-----Original Message-----

From: Fahey Douglas A
Sent: Wednesday, December 22, 2004 12:14 PM
To: Ackerman Jonathan - OTP; Ashford Tamara W
Cc: Hubbard Helen - OTP; DeNovio Nicholas J; Brown Robert M; Blaine George J; Crisalli Donna M; Arndt Melissa D; Zelnik Jonathan R
Subject: SILO Notice

The attached proposed notice has been approved by CC:ITA and has been submitted to the Chief Counsel for approval.



SILO Notice

Clearance.doc (56 ..xecutive Summary .



SILO Notice

Doug Fahey
622-7

b6

Knapp Nancy V

From: Knapp Nancy V
Sent: Friday, December 10, 2004 4:58 PM
To: Barral Roland
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

I don't know if Zelnik ever advised DeNard as to CIP and ASG dates. I'll try to nail down next week.

-----Original Message-----

From: Barral Roland
Sent: Friday, December 10, 2004 4:53 PM
To: Knapp Nancy V; Tancer Jody S; Mirabito Diane R
Cc: Graziano Peter J
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Thanks

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 10, 2004 4:55 PM
To: Tancer Jody S; Mirabito Diane R
Cc: Graziano Peter J; Barral Roland
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

FYI - Just in case Peter isn't in today.

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 4:27 PM
To: &LM PG CIRC; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

THE ATTACHED DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE. YOU ARE HEREBY NOTIFIED THAT ANY DISCLOSURE, COPYING, OR DISTRIBUTION, OR THE TAKING OF ANY ACTION IN RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS OFFICIAL POSITIONS OF THE IRS.

<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

Knapp Nancy V

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Sent: Friday, December 10, 2004 4:53 PM
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<< File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-[REDACTED]
Fax: (202) 283-7176

b6

Knapp Nancy V

From: Mirabito Diane R
Sent: Friday, December 10, 2004 4:53 PM
To: Knapp Nancy V
Subject: Out of Office AutoReply: CIRC. -- SILO Listing Notice -- 12/18/04

I will be out of the office until 12/13. Please note that I will not have access to my e-mail or voicemail. If you have a question on LILOs or SILOS that cannot wait until I return to the office, please contact Tom Kerrigan at (516) 688- 56

Knapp Nancy V

From: Knapp Nancy V
Sent: Friday, December 10, 2004 4:55 PM
To: Tancer Jody S; Mirabito Diane R
Cc: Graziano Peter J; Barral Roland
Subject: FW: CIRC. – SILO Listing Notice – 12/18/04

FYI - Just in case Peter isn't in today.

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SILO Notice Green
12-10-04.doc...

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56

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SILO Notice Green
12-10-04.doc...

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Phone: (202) 283-
Fax: (202) 283-7176

56

Knapp Nancy V

From: Barral Roland
Sent: Friday, December 03, 2004 3:25 PM
To: Graziano Peter J; Knapp Nancy V
Subject: RE: SILO Projects

I bet is that Abby correctly interpreted Jon's comments. Moreover, Abby's perception of what Jon said is the more plausible scenario.

-----Original Message-----

From: Graziano Peter J
Sent: Friday, December 03, 2004 3:21 PM
To: Knapp Nancy V; Barral Roland
Subject: RE: SILO Projects

Well I may have misunderstood Jon. He said the Listing Notice had some minor changes as did the CIP. I thought he indicated that things should be done next week. Abby, who was also on the call didn't get that. She said that he really didn't commit to any date.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 3:13 PM
To: Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

Peter,

Did you say you talked to Jon this morning? Did you get a timeline?

Nancy

-----Original Message-----

From: DeNard Paul D [<mailto:Paul.D.DeNard@irs.gov>]
Sent: Friday, December 03, 2004 2:53 PM
To: Knapp Nancy V; Zelnik Jonathan R
Subject: RE: SILO Projects

CIP when, Listing When, ASG When Is there a timeline when this will be completed.

-----Original Message-----

From: Knapp Nancy V [<mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV>]
Sent: Friday, December 03, 2004 1:04 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; LaBelle Peter J; Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland; Claybough Cheryl P; DeNard Paul D; Petronchak Kathy K
Subject: RE: SILO Projects

Arlene,

I just spoke to Kathy Petronchak, who clarified that it was another executive who thought the SILO CIP should be done next week. (My apologies for attributing that comment to her below.)

Kathy clarified her understanding that the SILO CIP will be released shortly after the release of the listing notice. That makes sense to me and we will operate on

that assumption.

Please keep me in the loop on the progress of both the listing notice and CIP. And let's give some thought to setting the deadline for the ASG.

Thanks,
Nancy

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:33 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E
Subject: RE: SILO Projects

Arlene,

At a shelter meeting this morning, Kathy Petronchak conveyed her understanding from Jon Zelnik that: (1) the SILO listing notice is expected by the end of the month; (2) the SILO CIP should be done next week; and (3) the SILO ASG may need to be revised.

The ASG/CIP report currently shows both projects in suspense, with no deadlines. I will call you today to try to reach agreement on how to update the report for the new information. It sounds like the CIP is fairly well set, so I'm more concerned with setting at least a rough deadline for the ASG. I realize we don't have the date of the listing notice yet, but I would be grateful for a deadline defined a number of days following publication of the listing notice.

Thanks for your assistance.

Nancy

-----Original Message-----

From: Blaine George J
Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

As the email below indicates, Treasury and CC have decided that the published listing notice should lead the body of guidance on SILOs. That is: the proposed CIP and ASG should not be issued until the listing notice is published, because the CIP and ASG need to be consistent with the notice. (Treasury is treating the listing notice as a priority; John Aramburu and I commented on a Treasury draft last week.) The CIP/ASG Report should reflect this status. I've asked Arlene Blume to work with Ray Kendrick on language to clarify the status of the CIP and ASG in the report.

Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

-----Original Message-----

From: Aramburu John M

Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

I spoke with Jon Zelnik regarding timetables for the various SILO projects. He agreed that the CIP and the ASG review need to follow issuance of the listing Notice, which will reflect the government's argument against the claimed tax benefits. The listing Notice is being worked on by Treasury. Jon has not yet received their draft. [REDACTED] b5

[REDACTED] Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-7 [REDACTED] b6

Knapp Nancy V

From: Barral Roland
Sent: Friday, December 03, 2004 3:23 PM
To: Knapp Nancy V; DeNard Paul D
Cc: Graziano Peter J
Subject: RE: SILO Projects

Yes - Peter spoke to Jon Zelnik this morning.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 3:15 PM
To: DeNard Paul D
Cc: Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

ITA's response. I'm waiting to hear from Peter G, who (I think) spoke w/Zelnik this morning.

-----Original Message-----

From: Blume Arlene A
Sent: Friday, December 03, 2004 1:11 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

That makes more sense.

As soon as we get some news on the status and proposed content of the listing notice, we can start planning how and when to follow up with the CIP and ASG.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 1:04 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; LaBelle Peter J; Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland; Claybough Cheryl P; DeNard Paul D; Petronchak Kathy K
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Nancy**

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John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

56

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Subject: RE: SILO Projects

CIP when, Listing When, ASG When Is there a timeline when this will be completed.

-----Original Message-----

From: Knapp Nancy V [<mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV>]
Sent: Friday, December 03, 2004 1:04 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; LaBelle Peter J; Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland; Claybough Cheryl P; DeNard Paul D; Petronchak Kathy K
Subject: RE: SILO Projects

Arlene,

I just spoke to Kathy Petronchak, who clarified that it was another executive who thought the SILO CIP should be done next week. (My apologies for attributing that comment to her below.)

Kathy clarified her understanding that the SILO CIP will be released shortly after the release of the listing notice. That makes sense to me and we will operate on that assumption.

Please keep me in the loop on the progress of both the listing notice and CIP. And let's give some thought to setting the deadline for the ASG.

Thanks,

Nancy

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:33 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E
Subject: RE: SILO Projects

Arlene,

At a shelter meeting this morning, Kathy Petronchak conveyed her understanding from Jon Zelnik that: (1) the SILO listing notice is expected by the end of the month; (2) the SILO CIP should be done next week; and (3) the SILO ASG may need to be revised.

The ASG/CIP report currently shows both projects in suspense, with no deadlines. I will call you today to try to reach agreement on how to update the report for the new information. It sounds like the CIP is fairly well set, so I'm more concerned with setting at least a rough deadline for the ASG. I realize we don't have the date of the listing notice yet, but I would be grateful for a deadline defined a number of days following publication of the listing notice.

Thanks for your assistance.

Nancy

-----Original Message-----

From: Blaine George J
Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

As the email below indicates, Treasury and CC have decided that the published listing notice should lead the body of guidance on SILOs. That is: the proposed CIP and ASG should not be issued until the listing notice is published, because the CIP and ASG need to be consistent with the notice. (Treasury is treating the listing notice as a priority; John Aramburu and I commented on a Treasury draft last week.) The CIP/ASG Report should reflect this status. I've asked Arlene Blume to work with Ray Kendrick on language to clarify the status of the CIP and ASG in the report.

Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

-----Original Message-----

From: Aramburu John M
Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

I spoke with Jon Zelnik regarding timetables for the various SILO projects. He agreed that the CIP and the ASG review need to follow issuance of the listing Notice, which will reflect the government's argument against the claimed tax benefits. The listing Notice is being worked on by Treasury. Jon has not yet

55
received their draft. [REDACTED]

[REDACTED] e. Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

56

Knapp Nancy V

From: Knapp Nancy V
Sent: Friday, December 03, 2004 3:15 PM
To: DeNard Paul D
Cc: Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

ITA's response. I'm waiting to hear from Peter G, who (I think) spoke w/Zelnik this morning.

-----Original Message-----

From: Blume Arlene A
Sent: Friday, December 03, 2004 1:11 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

That makes more sense.

As soon as we get some news on the status and proposed content of the listing notice, we can start planning how and when to follow up with the CIP and ASG.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 1:04 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; LaBelle Peter J; Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland; Claybough Cheryl P; DeNard Paul D; Petronchak Kathy K
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Kathy clarified her understanding that the SILO CIP will be released shortly after the release of the listing notice. That makes sense to me and we will operate on that assumption.

Please keep me in the loop on the progress of both the listing notice and CIP. And let's give some thought to setting the deadline for the ASG.

**Thanks,
Nancy**

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Nancy Knapp and John Aramburu,

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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED]

Knapp Nancy V

From: Knapp Nancy V
Sent: Friday, December 03, 2004 3:13 PM
To: Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

Peter,

Did you say you talked to Jon this morning? Did you get a timeline?

Nancy

-----Original Message-----

From: DeNard Paul D [<mailto:Paul.D.DeNard@irs.gov>]
Sent: Friday, December 03, 2004 2:53 PM
To: Knapp Nancy V; Zelnik Jonathan R
Subject: RE: SILO Projects

CIP when, Listing When, ASG When Is there a timeline when this will be completed.

-----Original Message-----

From: Knapp Nancy V [<mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV>]
Sent: Friday, December 03, 2004 1:04 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E; LaBelle Peter J; Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland; Claybough Cheryl P; DeNard Paul D; Petronchak Kathy K
Subject: RE: SILO Projects

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Subject: FW: SILO Projects

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[REDACTED] involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5

2 [REDACTED]

Knapp Nancy V

From: Graziano Peter J
Sent: Friday, December 03, 2004 1:39 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

Thanks, I talked to Jon this morning.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:34 PM
To: LaBelle Peter J
Cc: Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

Meant to cc you.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:33 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E
Subject: RE: SILO Projects

Arlene,

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Thanks for your assistance.

Nancy

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Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

56

Knapp Nancy V

From: LaBelle Peter J
Sent: Friday, December 03, 2004 12:34 PM
To: Knapp Nancy V
Subject: Out of Office AutoReply: SILO Projects

I will be out of the office on Friday December 3rd. If you need immediate assistance, please call Bettie Ricca at 202-283-[REDACTED]. You may leave a message for me at (202) 283-[REDACTED]

b6

Knapp Nancy V

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:34 PM
To: LaBelle Peter J
Cc: Tancer Jody S; Mirabito Diane R; Graziano Peter J; Barral Roland
Subject: FW: SILO Projects

Meant to cc you.

-----Original Message-----

From: Knapp Nancy V
Sent: Friday, December 03, 2004 12:33 PM
To: Blume Arlene A
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A; Blaine George J; Bowden George E
Subject: RE: SILO Projects

Arlene,

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Thanks for your assistance.

Nancy

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Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

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Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

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I spoke with Jon Zelnik regarding timetables for the various SILO projects. He agreed that the CIP and the ASG review need to follow issuance of the listing Notice, which will reflect the government's argument against the claimed tax benefits. The listing Notice is being worked on by Treasury. Jon has not yet received their draft. [REDACTED] 55

[REDACTED] Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED] 56

Knapp Nancy V

From: Tancer Jody S
Sent: Tuesday, November 23, 2004 9:15 AM
To: Knapp Nancy V
Cc: Mirabito Diane R
Subject: SILO ASG and CIP



FW: Status of SILO ASG SILO ASG/CIP on hold?

Nancy, do you know the status of the SILO ASG and CIP?



SILO CIP

Knapp Nancy V

From: Mirabito Diane R
Sent: Monday, November 22, 2004 10:44 AM
To: Graziano Peter J; Tancer Jody S
Subject: FW: Status of SILO ASG

-----Original Message-----

From: Onken Steven P [<mailto:Steven.P.Onken@irs.gov>]
Sent: Monday, November 22, 2004 9:37 AM
To: Arritola Luis E; Gibbs Steve A; Mirabito Diane R
Cc: Onken Steven P
Subject: RE: Status of SILO ASG

We did not want to 'withdraw' the ASG if it meant that this would push the final approval back. There was discussion of this last week that was perhaps going to result in Paul Denard and Dave Robison discussing whether there will be further delays. I will follow up.

Steve Onken, Appeals Team Manager
Technical Guidance Team 2
(651) 726- [REDACTED] (phone/VMS)

56

-----Original Message-----

From: Arritola Luis E
Sent: Friday, November 19, 2004 3:17 PM
To: Onken Steven P
Cc: Gibbs Steve A
Subject: FW: Status of SILO ASG

I think this is a question for the Steves.

I will tell Diane that I have passed the question on to you.

Thanks,

Luis

-----Original Message-----

From: Mirabito Diane R [<mailto:Diane.Mirabito@IRSCOUNSEL.TREAS.GOV>]
Sent: Wednesday, November 17, 2004 9:05 AM
To: Arritola Luis E
Cc: Tancer Jody S; Mirabito Diane R
Subject: Status of SILO ASG

Luis-I received an e-mail from Nancy Knapp, who handles submitted CIPs and ASGs for LMSB Division Counsel, that the review of the SILO ASG was on hold until the notice making SILOs listed transactions was published. Nancy asked Diane Ryan and Cindy Vassilwitch whether that was OK with Appeals and/or whether Appeals wanted to withdraw the proposed ASG. Do you know what position Appeals is taking? Thanks. Diane

Knapp Nancy V

From: Knapp Nancy V
Sent: Wednesday, November 17, 2004 3:35 PM
To: Tancer Jody S
Cc: Mirabito Diane R
Subject: SILO ASG/CIP on hold?

Diane Ryan is checking in w/Dave Robison. So is Paul DeNard.

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:33 PM
To: Ryan Diane AP
Subject: RE: SILO Projects

OK - I'll hold on your response on the suspense.

-----Original Message-----

From: Ryan Diane AP [<mailto:Diane.S.Ryan@irs.gov>]
Sent: Tuesday, November 16, 2004 4:16 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

Nancy,

Yes...thank you for the "heads-up"!!

Diane S. Ryan
Director of Technical Guidance, Appeals
(314) 612-

b6

-----Original Message-----

From: Knapp Nancy V [<mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV>]
Sent: Tuesday, November 16, 2004 3:25 PM
To: Ryan Diane AP; Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects


Paul DeNard wants to push back hard on any further delay. He is going to talk to Dave Robison in the next day or so. Do you want to check in with Dave first?

-----Original Message-----

From: Ryan Diane AP [<mailto:Diane.S.Ryan@irs.gov>]
Sent: Tuesday, November 16, 2004 4:07 PM
To: Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects

Nancy,

I suppose we will just "suspend" the draft. I have cc'd Phil Mahler so he also knows where we are here. Thanks, Nancy.

Diane S. Ryan
Director of Technical Guidance, Appeals
(314) 612-

b6

-----Original Message-----

From: Knapp Nancy V [mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV]
Sent: Monday, November 15, 2004 4:14 PM
To: Ryan Diane AP; Vassilowitch Cynthia A
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Mirabito Diane R; LaBelle Peter J; Lillie Thomas C
Subject: FW: SILO Projects

Diane and Cindy,

We're being told the SILO CIP and ASG are on hold pending issuance of a listing notice. Does Appeals want to withdraw its ASG request and wait for the listing notice? Or do you want to suspend the draft you've already submitted? Thanks.

Nancy Knapp
202/283- [REDACTED]

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

-----Original Message-----

From: Blaine George J
Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

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To: Blaine George J
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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED]

Knapp Nancy V

From: Barral Roland
Sent: Tuesday, November 16, 2004 4:32 PM
To: Knapp Nancy V; Blaine George J; Zelnik Jonathan R
Cc: Aramburu John M; Blume Arlene A; Kendrick Raymond A; Jackson William A; Bowden George E; Mirabito Diane R; Tancer Jody S; Graziano Peter J; LaBelle Peter J
Subject: SILO CIP

I just spoke to Paul DeNard again about this. Anticipating the development of an ASG, Paul was accelerating SILOs into FAST TRACK with the goal of having these use the ASG. [REDACTED] S:

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:24 PM
To: Blaine George J; Zelnik Jonathan R
Cc: Aramburu John M; Blume Arlene A; Kendrick Raymond A; Jackson William A; Bowden George E; Mirabito Diane R; Tancer Jody S; Graziano Peter J; Barral Roland; LaBelle Peter J
Subject: RE: SILO Projects
Importance: High

George and Jon,

I have not heard from Appeals yet. But Paul DeNard just stopped by and asked me to give you a head up that he intends to push back hard on further delay of the SILO CIP. Paul understood and accepted that the CIP was on hold [REDACTED] But he is very unhappy that the CIP will be delayed further for the listing notice. [REDACTED] S:

[REDACTED] S. Jon,
Paul will confer with Dave Robison and Debbie Nolan and will be in touch with you tomorrow.

Nancy

202/283-[REDACTED] 36

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

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-----Original Message-----

From: Aramburu John M
Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

I spoke with Jon Zelnik regarding timetables for the various SILO projects. He agreed that the CIP and the ASG review need to follow issuance of the listing Notice, which will reflect the government's argument against the claimed tax benefits. The listing Notice is being worked on by Treasury. Jon has not yet received their draft.

[REDACTED] Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED]

Knapp Nancy V

From: Knapp Nancy V
Sent: Wednesday, November 17, 2004 3:35 PM
To: Tancer Jody S
Cc: Mirabito Diane R
Subject: FW: SILO Projects

Diane Ryan is checking in w/Dave Robison. So is Paul DeNard.

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:33 PM
To: Ryan Diane AP
Subject: RE: SILO Projects

OK - I'll hold on your response on the suspense.

-----Original Message-----

From: Ryan Diane AP [<mailto:Diane.S.Ryan@irs.gov>]
Sent: Tuesday, November 16, 2004 4:16 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

Nancy,

Yes...thank you for the "heads-up"!!

Diane S. Ryan
Director of Technical Guidance, Appeals
(314) 612-

56

-----Original Message-----

From: Knapp Nancy V [<mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV>]
Sent: Tuesday, November 16, 2004 3:25 PM
To: Ryan Diane AP; Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects

Paul DeNard wants to push back hard on any further delay. He is going to talk to Dave Robison in the next day or so. Do you want to check in with Dave first?

-----Original Message-----

From: Ryan Diane AP [<mailto:Diane.S.Ryan@irs.gov>]
Sent: Tuesday, November 16, 2004 4:07 PM
To: Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects

Nancy,

I suppose we will just "suspend" the draft. I have cc'd Phil Mahler so he also knows where we are here. Thanks, Nancy.

Diane S. Ryan
Director of Technical Guidance, Appeals
(314) 612-

56

-----Original Message-----

From: Knapp Nancy V [mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV]
Sent: Monday, November 15, 2004 4:14 PM
To: Ryan Diane AP; Vassilowitch Cynthia A
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Mirabito Diane R; LaBelle Peter J; Lillie Thomas C
Subject: FW: SILO Projects

Diane and Cindy,

We're being told the SILO CIP and ASG are on hold pending issuance of a listing notice. Does Appeals want to withdraw its ASG request and wait for the listing notice? Or do you want to suspend the draft you've already submitted? Thanks.

Nancy Knapp
202/283- [REDACTED]

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

-----Original Message-----

From: Blaine George J
Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

As the email below indicates, Treasury and CC have decided that the published listing notice should lead the body of guidance on SILOs. That is: the proposed CIP and ASG should not be issued until the listing notice is published, because the CIP and ASG need to be consistent with the notice. (Treasury is treating the listing notice as a priority; John Aramburu and I commented on a Treasury draft last week.) The CIP/ASG Report should reflect this status. I've asked Arlene Blume to work with Ray Kendrick on language to clarify the status of the CIP and ASG in the report.

Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

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From: Aramburu John M
Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

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has not yet received their draft. [REDACTED]

[REDACTED] Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED]

Knapp Nancy V

From: Tancer Jody S
Sent: Wednesday, November 17, 2004 2:48 PM
To: Knapp Nancy V
Cc: Mirabito Diane R
Subject: RE: SILO Projects

Did you ever hear from appeals?

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:14 PM
To: Ryan Diane AP; Vassilowitch Cynthia A
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Mirabito Diane R; LaBelle Peter J; Lillie Thomas C
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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED] 56

Knapp Nancy V

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:47 PM
To: Barral Roland
Cc: LaBelle Peter J
Subject: RE: SILO Projects

I appreciate your observation, Roland. In his conversation with me, [REDACTED] I explained that our CIPs and ASGs have traditionally followed listing notices and advised him that our best bet might be to push for concurrent release of the CIP (and possibly ASG). I also advised him he would do well to confer with Dave and Debbie before calling Zelnik. But he did ask me to give Zelnik and Blaine the heads up I gave.

-----Original Message-----

From: Barral Roland
Sent: Tuesday, November 16, 2004 4:39 PM
To: Knapp Nancy V
Cc: LaBelle Peter J
Subject: RE: SILO Projects

Between us, Paul would adjust to it in any event. [REDACTED]

[REDACTED] I think that if Dave Robison adopts Diane Ryan's position, Paul will go along with it.

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:36 PM
To: Barral Roland
Cc: LaBelle Peter J
Subject: RE: SILO Projects

Roland,

Thanks for this important addition. Diane Ryan sent an e-mail while I was composing the e-mail to Zelnik and Blaine. Her initial reaction (apparently w/o Dave Robison's input) was to live with suspension of the ASG. But given Paul's view, she asked me to hold off on responding to Zelnik and Blain until Paul and Dave talk.

Nancy

-----Original Message-----

From: Barral Roland
Sent: Tuesday, November 16, 2004 4:32 PM
To: Knapp Nancy V; Blaine George J; Zelnik Jonathan R
Cc: Aramburu John M; Blume Arlene A; Kendrick Raymond A; Jackson William A; Bowden George E; Mirabito Diane R; Tancer Jody S; Graziano Peter J; LaBelle Peter J
Subject: RE: SILO Projects

I just spoke to Paul DeNard again about this. Anticipating the development of an ASG, [REDACTED]

[REDACTED]

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:24 PM
To: Blaine George J; Zelnik Jonathan R
Cc: Aramburu John M; Blume Arlene A; Kendrick Raymond A; Jackson William A; Bowden George E; Mirabito Diane R; Tancer Jody S; Graziano Peter J; Barral Roland; LaBelle Peter J
Subject: RE: SILO Projects
Importance: High

George and Jon,

I have not heard from Appeals yet. But Paul DeNard just stopped by and asked me to give you a head up that [REDACTED]

[REDACTED] Paul understood and accepted that the CIP was on hold [REDACTED]
[REDACTED] But he is very unhappy that the CIP will be delayed further for the listing notice. [REDACTED] 55

[REDACTED] Jon, Paul will confer with Dave Robison and Debbie Nolan and will be in touch with you tomorrow.

Nancy

202/283-[REDACTED] 56

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

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Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

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From: Aramburu John M
Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED] 56

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[REDACTED] I think that if Dave Robison adopts Diane Ryan's position, Paul will go along with it.

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202/283-[REDACTED] 56

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2-[REDACTED] 56

Knapp Nancy V

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:37 PM
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[REDACTED]

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[REDACTED]

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Paul understood and accepted that the CIP was on hold [REDACTED]

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2- [REDACTED]

Knapp Nancy V

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:33 PM
To: Ryan Diane AP
Subject: RE: SILO Projects

OK - I'll hold on your response on the suspense.

-----Original Message-----

From: Ryan Diane AP [mailto:Diane.S.Ryan@irs.gov]
Sent: Tuesday, November 16, 2004 4:16 PM
To: Knapp Nancy V
Subject: RE: SILO Projects

Nancy,


Yes...thank you for the "heads-up"!!

Diane S. Ryan
Director of Technical Guidance, Appeals
(314) 612-

56

-----Original Message-----

From: Knapp Nancy V [mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV]
Sent: Tuesday, November 16, 2004 3:25 PM
To: Ryan Diane AP; Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects

Paul DeNard  **He is going to talk to**
Dave Robison in the next day or so. Do you want to check in with Dave first?


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-----Original Message-----

From: Ryan Diane AP [mailto:Diane.S.Ryan@irs.gov]
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To: Knapp Nancy V
Cc: Mahler Phil
Subject: RE: SILO Projects

Nancy,

I suppose we will just "suspend" the draft. I have cc'd Phil Mahler so he also knows where we are here. Thanks, Nancy.

Diane S. Ryan
Director of Technical Guidance, Appeals
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-----Original Message-----

From: Knapp Nancy V [mailto:Nancy.V.Knapp@IRSCOUNSEL.TREAS.GOV]
Sent: Monday, November 15, 2004 4:14 PM
To: Ryan Diane AP; Vassilowitch Cynthia A
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Mirabito Diane R; LaBelle Peter J; Lillie Thomas C
Subject: FW: SILO Projects

Diane and Cindy,

We're being told the SILO CIP and ASG are on hold pending issuance of a listing notice. Does Appeals want to withdraw its ASG request and wait for the listing notice? Or do you want to suspend the draft you've already submitted? Thanks.

**Nancy Knapp
202/283- [REDACTED]**

36

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

-----Original Message-----

From: Blaine George J
Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

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Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

-----Original Message-----

From: Aramburu John M
Sent: Wednesday, November 03, 2004 1:08 PM
To: Blaine George J
Subject: SILO Projects

George,

I spoke with Jon Zelnik regarding timetables for the various SILO projects. He agreed that the CIP and the ASG review need to follow issuance of the listing Notice, which will reflect the government's argument against the claimed tax benefits. The listing Notice is being worked on by Treasury. Jon has not yet received their draft. [REDACTED]

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[REDACTED] Jon feels all involved should be aware that work on the CIP and ASG must await the listing Notice. But there is no harm in confirming this with those who submitted these documents. Should I call Nancy Knapp?

Thanks.

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2-
CC:ITA:5
Senior Counsel

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John Aramburu
Senior Counsel

CC:ITA:5

2- [REDACTED]

56

Knapp Nancy V

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:26 PM
To: DeNard Paul D
Subject: FW: SILO Projects

Importance: High

FYI

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 4:24 PM
To: Blaine George J; Zelnik Jonathan R
Cc: Aramburu John M; Blume Arlene A; Kendrick Raymond A; Jackson William A; Bowden George E; Mirabito Diane R; Tancer Jody S; Graziano Peter J; Barral Roland; LaBelle Peter J
Subject: RE: SILO Projects
Importance: High

George and Jon,

I have not heard from Appeals yet. But Paul DeNard just stopped by and asked me to give you a head up that [REDACTED]

Paul understood and accepted that the CIP was on hold [REDACTED]

**[REDACTED] Jon,
Paul will confer with Dave Robison and Debbie Nolan and will be in touch with you tomorrow.**

Nancy

202/283-[REDACTED]

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[REDACTED]. Jon, Paul will confer with Dave Robison and Debbie Nolan and will be in touch with you tomorrow.

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John Aramburu
Senior Counsel

CC:ITA:5

2- [REDACTED]

Knapp Nancy V

From: Mirabito Diane R
Sent: Tuesday, November 16, 2004 4:23 PM
To: Knapp Nancy V
Subject: Out of Office AutoReply: SILO Projects

56

**I will be working flexiplace on Wednesday, 1/17, and may be reached at [REDACTED]
Please note that I will not be able to open any e-mail sent secured and will not be able to
open any attachments.**

Knapp Nancy V

From: Tancer Jody S
Sent: Tuesday, November 16, 2004 4:23 PM
To: Knapp Nancy V
Subject: Out of Office AutoReply: SILO Projects

I will be out of the office the afternoon of November 16 and will return on the 17th. If you need immediate assistance, contact Ted Leighton at 516-688- [REDACTED]

56

Knapp Nancy V

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thanks. let us know what you hear.

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Cc: Graziano Peter J; Mirabito Diane R
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Jody, I forwarded the "compliance" e-mail to you and am confirming that I have not heard back from anyone yet.

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From: Tancer Jody S
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To: Knapp Nancy V
Cc: Graziano Peter J; Mirabito Diane R
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From: Tancer Jody S
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202/283

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Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

Thanks.

-----Original Message-----

From: Aramburu John M

Sent: Wednesday, November 03, 2004 1:08 PM

To: Blaine George J

Subject: SILO Projects

George,

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65

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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

b 6

Knapp Nancy V

From: Tancer Jody S
Sent: Tuesday, November 16, 2004 11:30 AM
To: Knapp Nancy V
Subject: RE: SILO Projects

Thanks.

-----Original Message-----

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 11:30 AM
To: Tancer Jody S
Subject: FW: SILO Projects

I see the problem. I inadvertently omitted you on this e-mail.

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:11 PM
To: Graziano Peter J
Cc: Barral Roland; Mirabito Diane R; LaBelle Peter J
Subject: FW: SILO Projects

Peter,

We're being told the SILO CIP and ASG are on hold pending issuance of a listing notice. Will you please coordinate this with Paul DeNard and Cheryl Claybough? Do they want to withdraw their CIP request? Or suspend the draft they've submitted? Thanks.

Nancy

283- 

66

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

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Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

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Nancy Knapp and John Aramburu,

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CC:ITA:5
2-[REDACTED]

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Thanks.

John Aramburu
Senior Counsel
CC:ITA:5
2-[REDACTED] 56

Knapp Nancy V

From: Knapp Nancy V
Sent: Tuesday, November 16, 2004 11:28 AM
To: Tancer Jody S
Cc: Graziano Peter J; Mirabito Diane R
Subject: RE: SILO Projects

I thought I sent you the one to check w/compliance as well. Let me check...

-----Original Message-----

From: Tancer Jody S
Sent: Tuesday, November 16, 2004 11:25 AM
To: Knapp Nancy V
Cc: Graziano Peter J; Mirabito Diane R
Subject: FW: SILO Projects

Diane and I were on the phone with Paul DeNard discussing various items and the status of the CIP/ASG came up. We mentioned the delay/suspension of the CIP/ASG to Paul and he said he was going to call you. I notice that your email that you forwarded to us is the one to appeals re: the ASG, you mentioned that you were going to ask compliance about the CIP, did you get a response from either?

-----Original Message-----

From: Tancer Jody S
Sent: Tuesday, November 16, 2004 11:12 AM
To: DeNard Paul D
Subject: FW: SILO Projects

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:14 PM
To: Ryan Diane AP; Vassilowitch Cynthia A
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Mirabito Diane R; LaBelle Peter J; Lillie Thomas C
Subject: FW: SILO Projects

Diane and Cindy,

We're being told the SILO CIP and ASG are on hold pending issuance of a listing notice. Does Appeals want to withdraw its ASG request and wait for the listing notice? Or do you want to suspend the draft you've already submitted? Thanks.

Nancy Knapp

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202/283-8622

-----Original Message-----

From: Knapp Nancy V
Sent: Monday, November 15, 2004 5:06 PM
To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
Subject: RE: SILO Projects

Thanks for the information. I will coordinate with LMSB and Appeals to see if they want to suspend or withdraw their draft documents.

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Sent: Monday, November 15, 2004 11:45 AM
To: Knapp Nancy V; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Blaine George J; Jackson William A
Subject: FW: SILO Projects

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Nancy Knapp and John Aramburu,

Please inform interested Counsel, Service, and Appeals personnel of this status. (John, please coordinate as appropriate with the drafters of the CIP and ASG, while the listing notice proceeds.)

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Thanks.

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John Aramburu
Senior Counsel
CC:ITA:5
2-

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Knapp Nancy V

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Nancy Knapp
202/283 

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To: Blaine George J; Blume Arlene A; Bowden George E
Cc: Aramburu John M; Zelnik Jonathan R; Kendrick Raymond A; Jackson William A
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CC:ITA:5
 2- [REDACTED]

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Senior Counsel

CC:ITA:5

2- [REDACTED] 56

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Nancy
283 [REDACTED]

56

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John Aramburu
Senior Counsel
CC:ITA:5
2-7 [REDACTED]

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56

Knapp Nancy V

From: Mattson Cynthia J
Sent: Sunday, October 12, 2003 5:55 PM
To: Mirabito Diane R
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Kerrigan Thomas J; Blum Steven H; Grimm Danielle M; Knapp Nancy V; Kastl Robert J
Subject: RE: Summary of SILO Joint-Briefing - October 8, 2003

Thanks.

-----Original Message-----

From: Mirabito Diane R
Sent: Thursday, October 09, 2003 9:47 AM
To: Mattson Cynthia J
Cc: Barral Roland; Graziano Peter J; Tancer Jody S; Kerrigan Thomas J; Mirabito Diane R
Subject: RE: Summary of SILO Joint-Briefing - October 8, 2003

Cindy-my notes included a few more items about yesterday's conference call. Thanks for this summary, it was hard to hear the side conversations Steve noted. 65

Please let me know if you need anything further. Diane

-----Original Message-----

From: Mattson Cynthia J
Sent: Thursday, October 09, 2003 5:38 AM
To: Mirabito Diane R
Subject: FW: Summary of SILO Joint-Briefing - October 8, 2003

Anything more?

-----Original Message-----

From: Blum Steven H
Sent: Wednesday, October 08, 2003 4:19 PM
To: Grimm Danielle M; Mattson Cynthia J; Kastl Robert J; Knapp Nancy V
Subject: Summary of SILO Joint-Briefing - October 8, 2003

Confidential: Attorney-Client Privileged Communication

Knapp Nancy V

From: Blum Steven H
Sent: Wednesday, October 08, 2003 8:26 AM
To: &LM HQ Employees
Subject: Whereabouts

Please note that I will be in a meeting on SILOs in Room 3026 of the National Office from 9:30 a.m. through 4:00 p.m. I will return to the office after that meeting. Should you need to reach me, please leave me a message on my voicemail, which I will check periodically.

Regards,

Steve Blum
X3- [REDACTED]

b6

Knapp Nancy V

From: Grimm Danielle M
Sent: Friday, October 03, 2003 1:17 PM
To: Blum Steven H; Knapp Nancy V
Subject: FW: Task Force Meeting to Discuss Certain SILO Issues

FYI - field counsel participation

-----Original Message-----

From: Tancer Jody S
Sent: Friday, October 03, 2003 1:16 PM
To: Grimm Danielle M
Subject: RE: Task Force Meeting to Discuss Certain SILO Issues

Danielle, Diane will be attending this by telephone as will Peter Graziano. I will be in a meeting in Chicago that day.

-----Original Message-----

From: Grimm Danielle M
Sent: Friday, October 03, 2003 12:01 PM
To: Tancer Jody S
Cc: Knapp Nancy V; Blum Steven H; Mirabito Diane R
Subject: FW: Task Force Meeting to Discuss Certain SILO Issues

Just forwarding this to you because I did not see your name on the initial distribution list.

No specific time has yet been set for Wed's meeting.

-----Original Message-----

From: Lay Matthew W
Sent: Wednesday, October 01, 2003 12:42 PM
To: Mattson Cynthia J; Grimm Danielle M
Cc: DeNovio Nicholas J
Subject: FW: Task Force Meeting to Discuss Certain SILO Issues

Fyi, we are planning to meet on SILOs next Wednesday, probably in room 4415. We will keep you informed on our progress on SILOs.

-----Original Message-----

From: Lay Matthew W
Sent: Monday, September 29, 2003 2:25 PM
To: DeNard Paul D; Prager JoAnn; Brown Robert M; Shatz Eileen M; Barral Roland; Mirabito Diane R; Allen Cary D
Cc: Brown Robert M; DeNovio Nicholas J; Zelnik Jonathan R; O'Connor David F P; Setzer Theodore D; Lay Matthew W; Snoddy Linda E
Subject: Task Force Meeting to Discuss Certain SILO Issues

Nick has asked me to schedule an extended meeting to discuss Sale-in, Lease-out transactions (SILOs). We will probably meet for two hours to discuss [REDACTED] then break for lunch and reconvene for two hours to [REDACTED] 55

Please let me know if you [or your designates] would be available October 8 between 10 and 3, or (if not) what days between now and October 17 you would be available. Anyone not in DC would be welcome to attend by telephone, if that is more convenient.

We have thoroughly studied the documents implementing these deals, and put together two PowerPoint presentations, which I have attached. One presentation relates to [REDACTED] and one presentation relates to [REDACTED]. Please let us know if there are any significant factual variations between transactions you may have studied and the transactions summarized here. 55

<< File: [REDACTED] Diagram Revised 9 29 03 anonymous.ppt >> << File: [REDACTED] am 9 29 03 anonymous.ppt >>

The purpose of the meeting will be to [REDACTED]

55

We are not planning to discuss technical issues relating to the [REDACTED]
[REDACTED], although this office and ITA are continuing to consider such issues.

Matthew Lay
Room 3503
(202) 622-[REDACTED]

56

Knapp Nancy V

From: Grimm Danielle M
Sent: Friday, October 03, 2003 12:07 PM
To: Knapp Nancy V; Blum Steven H
Subject: FW: SILOs

FYI - this is the rest of the email track on these issues. I left messages w Diane Mirabito and Jody Tancer to determine if they are attending the meeting.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Thursday, October 02, 2003 5:22 PM
To: Lay Matthew W; Allen Cary D
Cc: Prager JoAnn; Mirabito Diane R; Grimm Danielle M; O'Connor David F P; Zelnik Jonathan R
Subject: RE: SILOs

Treasury is attending and it might be useful for them to hear this.

-----Original Message-----

From: Lay Matthew W
Sent: Thursday, October 02, 2003 1:26 PM
To: Allen Cary D
Cc: Prager JoAnn; Mirabito Diane R; Grimm Danielle M; DeNovio Nicholas J; O'Connor David F P; Zelnik Jonathan R
Subject: SILOs

For our meeting next Wednesday, can you supply data regarding

(1) [REDACTED]

(2) [REDACTED]

Naturally, if you already have some or all of this information in an easy to understand format, we would appreciate receiving it before Wednesday. I realize you may have sent similar analyses in the past, but I'm sure the numbers are always changing.

Thanks!

Matthew Lay
Room 3503
(202) 622-[REDACTED]

Knapp Nancy V

From: Grimm Danielle M
Sent: Friday, October 03, 2003 12:01 PM
To: Tancer Jody S
Cc: Knapp Nancy V; Blum Steven H; Mirabito Diane R
Subject: FW: Task Force Meeting to Discuss Certain SILO Issues

Follow Up Flag: Follow up
Flag Status: Flagged

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Diagram Revis...

03 anonymous....

The purpose of the meeting will be to discuss and develop [REDACTED] 55

We are not planning to discuss t [REDACTED]
[REDACTED] although this office and ITA are continuing to consider such issues.

Matthew Lay
Room 3503
(202) 622-[REDACTED] 56

Grimm Danielle M

From: Arndt Melissa D
Sent: Wednesday, December 22, 2004 1:29 PM
To: &LM PG Circ
Cc: &LM Shelters
Subject: FW: SILO Notice

FYI

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

-----Original Message-----

From: Fahey Douglas A
Sent: Wednesday, December 22, 2004 12:14 PM
To: Ackerman Jonathan - OTP; Ashford Tamara W
Cc: Hubbard Helen - OTP; DeNovio Nicholas J; Brown Robert M; Blaine George J; Crisalli Donna M; Arndt Melissa D; Zelnik Jonathan R
Subject: SILO Notice

The attached proposed notice has been approved by CC:ITA and has been submitted to the Chief Counsel for approval.



SILO Notice
Clearance.doc (56 ..xecutive Summary .



SILO Notice

Doug Fahey
622-
[REDACTED]

b6

Grimm Danielle M

From: Arndt Melissa D
Sent: Monday, December 20, 2004 3:53 PM
To: &LM All IP; &LM Shelters; Allen Cary D; McClanahan III Frank C; Mirabito Diane R; Liberator Amy; Winters Michael A; Petronchak Kathy K; O'Donnell Douglas W; Grimm Danielle M; Arndt Melissa D
Cc: LaBelle Peter J; Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Attached is a revised draft of the SILO Notice showing changes from the green sheet copy.



SILO Notice
Clearance 12-20-04..

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

-----Original Message-----

From: Aramburu John M
Sent: Monday, December 20, 2004 1:46 PM
To: Crisalli Donna M; Arndt Melissa D
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

Thanks to all who commented. I am responding to your request that we notify you of how the comments were handled.

Cary Allen had essentially two comments. [REDACTED]

55

Should I send you or someone else at Division Counsel a draft that incorporates adopted changes?

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

54

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

56

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?

<<Message: FW: CIRC. -- SILO Listing Notice -- 12/18/04 >> Thanks,

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283- [REDACTED]
Fax: (202) 283-7176

54

-----Original Message-----

From: McClanahan III Frank C
Sent: Monday, December 13, 2004 8:40 AM
To: Arndt Melissa D
Cc: Dow Harmon B
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Hi Melissa. I have some comments on the Notice. [REDACTED]

55

65

MAC

-----Original Message-----

From: Dow Harmon B
Sent: Friday, December 10, 2004 4:25 PM
To: William Merkle (Merkle William G); Benjamin De Luna (De Luna Benjamin A); Fried Clint M (Clint.M.Fried@IRSCOUNSEL.TREAS.GOV); Gannon Richard H (Richard.H.Gannon@IRSCOUNSEL.TREAS.GOV); James Lanning (James.C.Lanning@IRSCOUNSEL.TREAS.GOV); Pam Gibson V (Gibson Pam V); Reid Huey (Huey Reid M); Bob Shilliday Jr (Shilliday Robert Jr J); Steven Guest (Guest Steven R); Vicki Hyche (Hyche Vicki J); Rogelio Villageliu (Villageliu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahanIII@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following technis file:
2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04


This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

THE ATTACHED DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE. YOU ARE HEREBY NOTIFIED THAT ANY DISCLOSURE, COPYING, OR DISTRIBUTION, OR THE TAKING OF ANY ACTION IN RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE

**POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS
OFFICIAL POSITIONS OF THE IRS.**

<<File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

Grimm Danielle M

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 11:12 AM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: RE: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Please provide your comments on the guidance described below to George Blaine and John Aramburu. Thank you.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

bl

-----Original Message-----

From: Crisalli Donna M
Sent: Friday, December 10, 2004 2:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions. Comments are requested by COB December 17.

<< File: SILO Notice Green 12-10-04.doc >> << File: SILO Notice Executive Summary .doc >>

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

bl

Grimm Danielle M

From: LaBelle Peter J
Sent: Friday, December 10, 2004 3:44 PM
To: Barral Roland; Graziano Peter J; Grimm Danielle M; Mirabito Diane R; Dunnigan Abigail Foster
Subject: FW: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Finally.

Peter J. LaBelle
Acting Division Counsel
Phone - (202) 283-
Fax - (202) 283-7176

-----Original Message-----

From: Crisalli Donna M
Sent: Friday, December 10, 2004 2:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions. Comments are requested by COB December 17.



SILO Notice Green
12-10-04.doc...



SILO Notice
xecutive Summary .

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-

Grimm Danielle M

From: Crisalli Donna M
Sent: Friday, December 10, 2004 2:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kaizen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions. Comments are requested by COB December 17.



SILO Notice Green
12-10-04.doc...



SILO Notice
Executive Summary .

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

56

Blum Steven H

From: Arndt Melissa D
Sent: Wednesday, December 22, 2004 1:29 PM
To: &LM PG Circ
Cc: &LM Shelters
Subject: FW: SILO Notice

FYI

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

b6

-----Original Message-----

From: Fahey Douglas A
Sent: Wednesday, December 22, 2004 12:14 PM
To: Ackerman Jonathan - OTP; Ashford Tamara W
Cc: Hubbard Helen - OTP; DeNovio Nicholas J; Brown Robert M; Blaine George J; Crisalli Donna M; Arndt Melissa D; Zelnik Jonathan R
Subject: SILO Notice

The attached proposed notice has been approved by CC:ITA and has been submitted to the Chief Counsel for approval.



SILO Notice
Clearance.doc (56 ..xecutive Summary .



SILO Notice

Doug Fahey
622-
[REDACTED]

b6

Blum Steven H

From: Mattson Cynthia J
Sent: Friday, June 04, 2004 1:52 PM
To: Blum Steven H
Subject: FW: SILOs

-----Original Message-----

From: Mattson Cynthia J
Sent: Friday, June 04, 2004 1:52 PM
To: DeNovio Nicholas J
Cc: Mattson Cynthia J
Subject: RE: SILOs

I appreciate your time on this. I will wait to hear after you have had a chance to talk to Don. Please raise with him my points about the benefits of listing. Thanks.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Friday, June 04, 2004 1:49 PM
To: Mattson Cynthia J
Subject: RE: SILOs

Cindy - Jon Z. and I have been trying to get a block of time with the CC to discuss this but have not yet done so. [REDACTED]

I will get with Don K and then get back to you. At this point I think that any discussions between Counsel and Treasury on the issue need to be between Don and Greg.

NJD

-----Original Message-----

From: Mattson Cynthia J
Sent: Friday, June 04, 2004 12:57 PM
To: DeNovio Nicholas J
Cc: Mattson Cynthia J
Subject: RE: SILOs

Nick - I have heard from a couple of sources that [REDACTED]

[REDACTED]

[REDACTED]. Please get back to me on this.

Thanks. Cindy.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Tuesday, May 25, 2004 5:27 PM
To: Mattson Cynthia J
Cc: Arndt Melissa D
Subject: RE: SILOs

I have not heard anything recently from Treasury but will check. Don Korb also mentioned

that he wanted to speak to Jon Z and me about the topic. I will get back to you after we meet. Emily and I had briefed him on the transaction and the background (joint briefing in Dec.; draft listing notice with Treas.), shortly before she left.

NJD

-----Original Message-----

From: Mattson Cynthia J
Sent: Tuesday, May 25, 2004 4:39 PM
To: DeNovio Nicholas J
Cc: Mattson Cynthia J; Arndt Melissa D
Subject: SILOs

Nick - what is the status of the SILO notice at Treasury? This is one of LMSB's 6 highest priority published guidance projects. Thanks. Cindy.

Cynthia J. Mattson
Division Counsel (LMSB)
The Mint Building - M-4-194
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
202-283-8600, 202-283-7176 (fax)

Blum Steven H

From: Mattson Cynthia J
Sent: Sunday, January 18, 2004 12:15 PM
To: DeNovio Nicholas J
Cc: Barral Roland; Ng Frank Y; Nolan Deborah M (LMSB); Blum Steven H; Grimm Danielle M; DeNard Paul D; Mattson Cynthia J
Subject: FW: SILO Notice 1-16-04.doc



SILO Notice
-16-04.doc (118 K) 1-16-04 (checked)...

Thanks for keeping the LMSB team in the loop on this. It is greatly appreciated. Cindy.

-----Original Message-----

From: Blum Steven H
Sent: Friday, January 16, 2004 3:21 PM
To: Grimm Danielle M; Mattson Cynthia J
Subject: FW: SILO Notice 1-16-04.doc

FYI.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Friday, January 16, 2004 3:20 PM
To: Mirabito Diane R; Allen Cary D; Prager JoAnn; Aramburu John M; Shatz Eileen M; Blum Steven H; Stevens Matthew A; Pugh Cary D
Cc: Lay Matthew W; Zelnik Jonathan R
Subject: FW: SILO Notice 1-16-04.doc

Latest draft. Please forward within your offices/groups.

Comments to Matt Lay please by Wednesday January 21.

Thanks.

Blum Steven H

From: DeNovio Nicholas J
Sent: Friday, January 16, 2004 3:20 PM
To: Mirabito Diane R; Allen Cary D; Prager JoAnn; Aramburu John M; Shatz Eileen M; Blum Steven H; Stevens Matthew A; Pugh Cary D
Cc: Lay Matthew W; Zelnik Jonathan R
Subject: FW: SILO Notice 1-16-04.doc



SILO Notice
-16-04.doc (118 K) -16-04 (checked)...

Latest draft. Please forward within your offices/groups.

Comments to Matt Lay please by Wednesday January 21.

Thanks.

Blum Steven H

From: Aramburu John M
Sent: Monday, January 05, 2004 8:44 AM
To: Lay Matthew W; Hubbard Helen - OTP; Cohen Jodi - OTP; Ackerman Jonathan - OTP; Parker Emily A; Wilcox Gary B; Pugh Cary D; Stevens Matthew A; Brown Robert M; Blaine George J; DeNard Paul D; Barral Roland; Mattson Cynthia J; Blum Steven H; Klotsche John C; Kastl Robert J; Nolan Deborah M (LMSB); Ng Frank Y; Autry Patricia J; Graziano Peter J; Claytor Paul; Allen Cary D; Prager JoAnn; Mirabito Diane R; Jackson William A; Schwartz Edward C; Maloy Heather; Shatz Eileen M; Ramsey Charles B; Tancer Jody S; Grimm Danielle M; Baker Mary B; Fernandez Lewis J; O'Shea William P; Kroening Linda M; DeNovio Nicholas J; Zelnik Jonathan R; O'Connor David F P; Setzer Theodore D; Preston Arlene; Snoddy Linda E
Subject: RE: SILO Notice 2d Draft

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-----Original Message-----

From: Lay Matthew W
Sent: Friday, December 19, 2003 11:08 AM
To: Hubbard Helen - OTP; Cohen Jodi - OTP; Ackerman Jonathan - OTP; Parker Emily A; Wilcox Gary B; Pugh Cary D; Stevens Matthew A; Brown Robert M; Blaine George J; DeNard Paul D; Barral Roland; Mattson Cynthia J; Blum Steven H; Klotsche John C; Kastl Robert J; Nolan Deborah M (LMSB); Mattson Cynthia J; Ng Frank Y; Autry Patricia J; Graziano Peter J; Claytor Paul; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Jackson William A; Schwartz Edward C; Maloy Heather; Shatz Eileen M; Ramsey Charles B; Aramburu John M; Tancer Jody S; Grimm Danielle M; Baker Mary B; Fernandez Lewis J; O'Shea William P; Kroening Linda M
Cc: DeNovio Nicholas J; Zelnik Jonathan R; O'Connor David F P; Setzer Theodore D; Preston Arlene; Snoddy Linda E; Lay Matthew W
Subject: SILO Notice 2d Draft

Attached please find a revised draft of the SILO Notice. Recognizing that many of us will be out of the office with the pending holidays, vacations, etc. please try to send comments back by January 6, 2004.

<< File: SILO Notice 12-19-03.doc >>

The significant change (compared to the first draft) is [REDACTED]

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Starting with the next draft, we will send a blacklined version of each draft.

-----Original Message-----

From: Lay Matthew W

Sent: Tuesday, December 09, 2003 10:58 AM

To: Olson Pam - OTP; Jenner Gregory - OTP; Solomon Eric - OTP; Hubbard Helen - OTP; Cohen Jodi - OTP; Ackerman Jonathan - OTP; Parker Emily A; Wilcox Gary B; Pugh Cary D; Stevens Matthew A; Brown Robert M; Blaine George J; DeNard Paul D; Barral Roland; Mattson Cynthia J; Blum Steven H; Arritola Luis E; Onken Steven P; Klotsche John C; Kastl Robert J; Nolan Deborah M (LMSB); Mattson Cynthia J; Ng Frank Y; Autry Patricia J; Graziano Peter J; Claytor Paul; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Jackson William A; Schwartz Edward C; Maloy Heather; Shatz Eileen M; Ramsey Charles B; Aramburu John M; Tancer Jody S; Grimm Danielle M; Baker Mary B; Fernandez Lewis J; O'Shea William P; Kroening Linda M

Cc: DeNovio Nicholas J; Zelnik Jonathan R; O'Connor David F P; Setzer Theodore D; Preston Arlene; Lay Matthew W; Snoddy Linda E

Subject: SILO joint briefing

The SILO joint briefing is scheduled for this Thursday, December 11, 2003, at 1111 Constitution Ave, NW, Room 4415, from 10 a.m. to noon. Attached please find a memorandum, diagrams for the memorandum, and a draft Notice that would designate SILOs as listed transactions. Please note that in the draft Notice, for discussion purposes there are two complete fact patterns -- ~~one involving a transaction between a SILO and a non-SILO entity~~

~~one involving a transaction between a SILO and a non-SILO entity~~ For purposes of the briefing, however, we thought that two complete fact situations would be helpful.

<< File: Memorandum.doc >> << File: Diagrams.ppt >> << File: Notice.doc >>

For those who cannot attend in person, a conference call will be arranged. We will send the code for you to call in by cob tomorrow.

Matthew Lay
Room 3503
(202) 622-~~XXXX~~

56

Blum Steven H

From: Mattson Cynthia J
Sent: Wednesday, December 03, 2003 7:31 PM
To: Preston Arlene; Zelnik Jonathan R; Claytor Paul; DeNard Paul D; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Grimm Danielle M; Baker Mary B; Setzer Theodore D; O'Connor David F P; Lay Matthew W; Barral Roland; DeNovio Nicholas J; Stevens Matthew A; Parker Emily A; Wilcox Gary B; Pugh Cary D; Parker Emily A
Cc: Mattson Cynthia J
Subject: RE: December 4th Joint Treasury Briefing

Arlene:

This new date conflicts with an LMSB [REDACTED] in NY to be attended by Mark Matthews and John Klotsche, in addition to Paul DeNard, Roland Barral and me. Recommend changing the date from the 11th. 55

Cindy.

-----Original Message-----

From: Preston Arlene
Sent: Wednesday, December 03, 2003 3:33 PM
To: Zelnik Jonathan R; Claytor Paul; DeNard Paul D; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B; Setzer Theodore D; O'Connor David F P; Lay Matthew W; Barral Roland; DeNovio Nicholas J; Stevens Matthew A; Parker Emily A; Wilcox Gary B; Pugh Cary D
Subject: December 4th Joint Treasury Briefing

Message to SILO Participants: Please note the following. Thanks.

-----Original Message-----

From: Preston Arlene
Sent: Wednesday, December 03, 2003 3:20 PM
To: Zelnik Jonathan R; Alexander William D; Angus Barbara - OTP; Brown Robert M; Butler Deborah A; Cain Derek E; Carlisle Richard L; Cohen Jodi - OTP; Cronin Edward F (Ted) - CT; DeNovio Nicholas J; Dewland Pamela - OTP; Doran Michael - OTP; Dubert Carl - OTP; Fernandez Lewis J; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Janet.Jones@do.treas.gov; Jenner Gregory - OTP; Kim Julian - OTP; Kissel Benedetta A; Kroening Linda M; Lay Matthew W; Livingston Catherine E; Maloy Heather; Marks Nancy J; Mattson Cynthia J; Musher Steven A; O'Connor David F P; Olds Frances - OTP; Olson Pam - OTP; O'Shea William P; Paris Dominic A; Parker Emily A; Pugh Cary D; Ricca Bettie N; Setzer Theodore D; Smith Lon B; Solomon Eric - OTP; Stevens Matthew A; Sweetnam Bill Jr - OTP; Tawshunsky Alan; Thomas Tom R; traci.altman@do.treas.gov; Wilcox Gary B
Subject: December 4th Joint Treasury Briefing

The Joint Briefing on SILOS scheduled for Thursday, December 4 from 9:30A to 12:00P has been CANCELLED and is rescheduled for Thursday, December 11 from 10:00A to 12:00P We will update you on the other agenda topics for the December 11 briefing shortly. Thanks.

Arlene Preston
Secretary to the Deputy Chief Counsel (Operations)
Room 3026
202/622-3310 (main no.)
202/622-4277 (fax no.)
Arlene.Preston@irsounsel.treas.gov

56

Blum Steven H

From: Claytor Paul [Paul.Claytor@irs.gov]
Sent: Wednesday, December 03, 2003 4:08 PM
To: Blum Steven H; Allen Cary D; Prager JoAnn; Claytor Paul; DeNard Paul D
Subject: RE: December 4th Joint Treasury Briefing

Hey, don't apologize... If anything we are agile and we all keep our calendars in pencil or erasable bytes....

Paul Claytor
Senior Industry Advisor
Financial Services
Large and Mid-Size Business Division
630-493-
paul.claytor@irs.gov

66

-----Original Message-----

From: Blum Steven H [mailto:Steven.H.Blum@irscounsel.treas.gov]
Sent: Wednesday, December 03, 2003 2:46 PM
To: Allen Cary D; Prager JoAnn; Claytor Paul; DeNard Paul D
Subject: FW: December 4th Joint Treasury Briefing

I'm sorry about this. They just don't seem to have their act together on meeting. I'm sure a lot is going on, but this is not enough notice.

-----Original Message-----

From: Zelnik Jonathan R
Sent: Wednesday, December 03, 2003 3:29 PM
To: Claytor Paul; DeNard Paul D; Baker Mary B; Prager JoAnn; Blum Steven H; Schwartz Edward C; Blaine George J; Aramburu John M
Subject: FW: December 4th Joint Treasury Briefing

-----Original Message-----

From: Preston Arlene
Sent: Wednesday, December 03, 2003 3:20 PM
To: Zelnik Jonathan R; Alexander William D; Angus Barbara - OTP; Brown Robert M; Butler Deborah A; Cain Derek E; Carlisle Richard L; Cohen Jodi - OTP; Cronin Edward F (Ted) - CT; DeNovio Nicholas J; Dewland Pamela - OTP; Doran Michael - OTP; Dubert Carl - OTP; Fernandez Lewis J; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Janet.Jones@do.treas.gov; Jenner Gregory - OTP; Kim Julian - OTP; Kissel Benedetta A; Kroening Linda M; Lay Matthew W; Livingston Catherine E; Maloy Heather; Marks Nancy J; Mattson Cynthia J; Musher Steven A; O'Connor David F P; Olds Frances - OTP; Olson Pam - OTP; O'Shea William P; Paris Dominic A; Parker Emily A; Pugh Cary D; Ricca Bettie N; Setzer Theodore D; Smith Lon B; Solomon Eric - OTP; Stevens Matthew A; Sweetnam Bill Jr - OTP; Tawshunsky Alan; Thomas Tom R; tradi.altman@do.treas.gov; Wilcox Gary B
Subject: December 4th Joint Treasury Briefing

The Joint Briefing on SILOS scheduled for Thursday, December 4 from 9:30A to 12:00P has been CANCELLED and is rescheduled for Thursday, December 11 from 10:00A to 12:00P We will update you on the other agenda topics for the December 11 briefing shortly. Thanks.

Arlene Preston
Secretary to the Deputy Chief Counsel (Operations)
Room 3026
202/622-3310 (main no.)
202/622-4277 (fax no.)
Arlene.Preston@irscounsel.treas.gov

66

Blum Steven H

From: Mattson Cynthia J
Sent: Thursday, November 13, 2003 1:55 PM
To: Blum Steven H
Subject: RE: SILOs

Good job

-----Original Message-----

From: Blum Steven H
Sent: Wednesday, November 12, 2003 9:37 AM
To: DeNard Paul D
Cc: Grimm Danielle M; Mattson Cynthia J
Subject: RE: SILOs

Thank you Paul. We will see you on November 24.

-----Original Message-----

From: DeNard Paul D [<mailto:Paul.D.DeNard@irs.gov>]
Sent: Wednesday, November 12, 2003 9:36 AM
To: Blum Steven H
Subject: RE: SILOs


I will be there

-----Original Message-----

From: Blum Steven H [<mailto:Steven.H.Blum@irs.counsel.treas.gov>]
Sent: Wednesday, November 12, 2003 9:30 AM
To: DeNard Paul D; Claytor Paul
Subject: FW: SILOs

Confidential: Attorney-Client Privileged Communication

Paul and Paul:

I'm an attorney on Cindy Mattson's staff. There will be a Joint-briefing on SILOs now scheduled for November 24, 2003 from 2-5 p.m. in Room 4415 of the National Office. 

b5


Would you let me know whether you will be able to attend? Please contact me, Diane Mirabito, or JoAnn Prager with any questions you might have.

Thank you for your help.

Regards,

Steve Blum
(202) 283- [REDACTED]

b6

-----Original Message-----

From: Mattson Cynthia J
Sent: Tuesday, November 11, 2003 5:10 PM
To: Grimm Danielle M; Blum Steven H
Subject: FW: SILOs

-----Original Message-----

From: DeNovio Nicholas J
Sent: Monday, November 03, 2003 9:35 AM
To: Mattson Cynthia J; Barral Roland
Cc: Zelnik Jonathan R
Subject: SILOs

b3/b6

Paul DeNard and Claytor called me Friday to discuss a [REDACTED]

The Nov 20th meeting/briefing on SILOs came up and I suggested that it is important enough for both to attend.

Just an FYI.

NJD

Blum Steven H

From: DeNard Paul D [Paul.D.DeNard@irs.gov]
Sent: Wednesday, November 12, 2003 9:36 AM
To: Blum Steven H
Subject: RE: SILOs

I will be there

-----Original Message-----

From: Blum Steven H [mailto:Steven.H.Blum@irscounsel.treas.gov]
Sent: Wednesday, November 12, 2003 9:30 AM
To: DeNard Paul D; Claytor Paul
Subject: FW: SILOs

Confidential: Attorney-Client Privileged Communication

Paul and Paul:

I'm an attorney on Cindy Mattson's staff. There will be a Joint-briefing on SILOs now scheduled for November 24, 2003 from 2-5 p.m. in Room 4415 of the National Office. [REDACTED]

[REDACTED]

Would you let me know whether you will be able to attend? Please contact me, Diane Mirabito, or JoAnn Prager with any questions you might have.

Thank you for your help.

Regards,

Steve Blum
(202) 283-[REDACTED]

-----Original Message-----

From: Mattson Cynthia J
Sent: Tuesday, November 11, 2003 5:10 PM
To: Grimm Danielle M; Blum Steven H
Subject: FW: SILOs

-----Original Message-----

From: DeNovio Nicholas J
Sent: Monday, November 03, 2003 9:35 AM
To: Mattson Cynthia J; Barral Roland
Cc: Zelnik Jonathan R

Subject: SILOs

63/6143

Paul DeNard and Claytor called me Friday to discuss a [REDACTED]

The Nov 20th meeting/briefing on SILOs came up and I suggested that it is important enough for both to attend.

Just an FYI.

NJD

Blum Steven H

From: Claytor Paul [Paul.Claytor@irs.gov]
Sent: Wednesday, November 12, 2003 9:33 AM
To: Blum Steven H; DeNard Paul D; Claytor Paul
Subject: RE: SILOs

I have it on my calendar. It is absolutely vital that Cary Allen is there. He REALLY understands the
[REDACTED]

Paul Claytor
Senior Industry Advisor
Financial Services
Large and Mid-Size Business Division
630-493-[REDACTED]
paul.claytor@irs.gov

-----Original Message-----

From: Blum Steven H [mailto:Steven.H.Blum@irscounsel.treas.gov]
Sent: Wednesday, November 12, 2003 8:30 AM
To: DeNard Paul D; Claytor Paul
Subject: FW: SILOs

Confidential: Attorney-Client Privileged Communication

Paul and Paul:

I'm an attorney on Cindy Mattson's staff. There will be a Joint-briefing on SILOs now scheduled for November 24, 2003 from 2-5 p.m. in Room 4415 of the National Office. [REDACTED]

Would you let me know whether you will be able to attend? Please contact me, Diane Mirabito, or JoAnn Prager with any questions you might have.

Thank you for your help.

Regards,

Steve Blum
(202) 283-[REDACTED]

-----Original Message-----

From: Mattson Cynthia J
Sent: Tuesday, November 11, 2003 5:10 PM
To: Grimm Danielle M; Blum Steven H
Subject: FW: SILOs

-----Original Message-----

From: DeNovio Nicholas J
Sent: Monday, November 03, 2003 9:35 AM
To: Mattson Cynthia J; Barral Roland
Cc: Zelnik Jonathan R
Subject: SILOs

Paul DeNard and Claytor called me Friday to discuss [REDACTED]

63/6103

The Nov 20th meeting/briefing on SILOs came up and I suggested that it is important enough for both to attend.

Just an FYI.

NJD

Blum Steven H

From: Mattson Cynthia J
Sent: Tuesday, November 11, 2003 5:09 PM
To: Blum Steven H; Grimm Danielle M
Cc: Mattson Cynthia J
Subject: RE: SILOs conference call

Sorry for delay. All fine with me. Can you double check and make sure that the 4 people he mentioned will be at the briefing? Thanks.

-----Original Message-----

From: Blum Steven H
Sent: Monday, November 03, 2003 11:38 AM
To: Mattson Cynthia J; Grimm Danielle M
Subject: SILOs conference call

Confidential: Attorney-Client Privileged Communication

Cindy and Danielle:

I was on a SILOs call with Nick DeNovio this morning. He discussed the Joint-Briefing currently set for November 20 with Treasury.

Nick indicated that he now strongly favors listing SILOs, but wants to base the listing notice on substance over form arguments similar to the arguments used in LILOs, rather than tax accounting arguments (about tacking and the Pickle rule trumping QTEs). The task force all agreed with Nick's thinking. Diane Mirabito and Jody Tancer were very helpful in emphasizing the need to list or get some kind of LMSB directive that will force agents to work these cases.

65

Please let me know if you have any questions.

Regards,

Steve Blum
X3- [REDACTED]

66

Blum Steven H

From: Mattson Cynthia J
Sent: Tuesday, November 11, 2003 5:10 PM
To: Grimm Danielle M; Blum Steven H
Subject: FW: SILOs

-----Original Message-----

From: DeNovio Nicholas J
Sent: Monday, November 03, 2003 9:35 AM
To: Mattson Cynthia J; Barral Roland
Cc: Zelnik Jonathan R
Subject: SILOs

Paul DeNard and Claytor called me Friday to discuss [REDACTED]

53/6103

The Nov 20th meeting/briefing on SILOs came up and I suggested that it is important enough for both to attend.

Just an FYI.

NJD

Blum Steven H

From: Blum Steven H
Sent: Thursday, November 06, 2003 9:31 AM
To: Allen Cary D; Blum Steven H
Cc: Zelnik Jonathan R
Subject: RE: SILO Briefing

Thank you Cary. We greatly appreciate your help and flexibility. As soon as Jon confirms the date and time, I will let you know.

-----Original Message-----

From: Allen Cary D [<mailto:Cary.Allen@irs.gov>]
Sent: Thursday, November 06, 2003 9:07 AM
To: Blum Steven H
Cc: Zelnik Jonathan R
Subject: RE: SILO Briefing

Steve/John,

I have a trip scheduled to visit 3 audit teams in the NYC area from 11-17 to 11-26. **I plan on adjusting my schedule to fit yours.** Just let me know what the final date, time and location will be. I have already booked a flight from LGA to DCA for the 20th but will change as needed. If possible try to set the final date by Friday the 14th so that I can change my flight(s) as needed.

CDA

-----Original Message-----

From: Blum Steven H [<mailto:Steven.H.Blum@irs.counsel.treas.gov>]
Sent: Wednesday, November 05, 2003 3:57 PM
To: Zelnik Jonathan R
Cc: Allen Cary D
Subject: RE: SILO Briefing

My understanding was that Cary was planning to come in on the 20th.

Cary:

Would you let Jon and me know about your availability for the afternoon of November 24th.

-----Original Message-----

From: Zelnik Jonathan R
Sent: Wednesday, November 05, 2003 3:55 PM
To: Blum Steven H
Cc: Allen Cary D
Subject: RE: SILO Briefing

Is Cary available for the 24th?

-----Original Message-----

From: Blum Steven H
Sent: Wednesday, November 05, 2003 3:55 PM
To: Zelnik Jonathan R
Cc: Allen Cary D; Prager JoAnn; Grimm Danielle M
Subject: FW: SILO Briefing
Importance: High

Jon:

When will you know for sure on the date? Cary Allen will need to know in order to make travel

arrangements into Washington.

Thank you for your help.

Steve Blum
(202) 283-

56

From: Zelnik Jonathan R
Sent: Wednesday, November 05, 2003 3:48 PM
To: Claytor Paul; DeNard Paul D; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B
Cc: O'Connor David F P; Lay Matthew W; Setzer Theodore D; DeNovio Nicholas J; Barral Roland
Subject: SILO Briefing
Importance: High

The SILO Briefing originally scheduled for November 20 may be rescheduled to November 24 (most likely the afternoon). If you are unable to attend on the 24th, please let me know.

Blum Steven H

From: Blum Steven H
Sent: Monday, November 03, 2003 1:16 PM
To: Prager JoAnn; Blum Steven H
Cc: Allen Cary D
Subject: RE: SILOs Joint Briefing (November 20, 2003)

JoAnn and Cary:

It is currently on the general joint-briefing schedule for 9 AM on the 20th in Room 4415 of the National Office. Diane Mirabito may have other information for you regarding what to expect.

-----Original Message-----


From: Prager JoAnn [<mailto:JoAnn.Prager@irs.gov>]
Sent: Monday, November 03, 2003 1:05 PM
To: Blum Steven H
Cc: Allen Cary D
Subject: RE: SILOs Joint Briefing (November 20, 2003)

Thanks for the info. As soon as you know when the briefing will be (AM or PM) let me know so we can make appropriate travel plans for Cary.

Jo Ann Prager

Manager, Tax Shelter Issues

LMSB: Prefiling and Technical Guidance, Group 10

Telephone: 202-283-

FAX: 202-283-8406

Cell Phone: 

b6

-----Original Message-----

From: Blum Steven H [<mailto:Steven.H.Blum@irs.counsel.treas.gov>]
Sent: Monday, November 03, 2003 11:49 AM
To: Allen Cary D; Prager JoAnn
Subject: SILOs Joint Briefing (November 20, 2003)

Hi JoAnn and Cary.

Nick DeNovio held a conference call this morning with Counsel regarding the Joint-Briefing at Treasury on SILOs currently set for November 20, 2003. He is 

b5

Blum Steven H

From: Grimm Danielle M
Sent: Friday, October 31, 2003 5:18 PM
To: Blum Steven H
Subject: RE: SILO MEETING

Steve, I assume you will continue to carry this matter for HQ ? Will you be participating in the call and briefing ?

-----Original Message-----

From: DeNovio Nicholas J
Sent: Wednesday, October 29, 2003 4:19 PM
To: Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B; Claytor Paul; DeNard Paul D; Zelnik Jonathan R; O'Connor David F P; Lay Matthew W; Setzer Theodore D
Cc: Snoddy Linda E
Subject: SILO MEETING

I would like to schedule a conference call for early next week to discuss next steps.

Given the number of participants and travel schedule, I would also suggest that we should at this time target a date for a joint briefing with Treasury.

Please consider November 20 or, more likely, December 4. Gary informs me that these are the two best alternatives before the new year, and I believe that we do not want to wait that long.

Please respond to Linda on conference call availability and your availability to attend either on the 20th or the 4th.

NJD

Blum Steven H

From: Mattson Cynthia J
Sent: Friday, October 31, 2003 1:54 PM
To: DeNovio Nicholas J; Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Grimm Danielle M; Baker Mary B; Claytor Paul; DeNard Paul D; Zelnik Jonathan R; O'Connor David F P; Lay Matthew W; Setzer Theodore D
Cc: Snoddy Linda E
Subject: RE: SILO MEETING

Will Linda be sending a calendar invitation to give us the time and place?

-----Original Message-----

From: DeNovio Nicholas J
Sent: Thursday, October 30, 2003 7:30 PM
To: Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B; Claytor Paul; DeNard Paul D; Zelnik Jonathan R; O'Connor David F P; Lay Matthew W; Setzer Theodore D
Cc: Snoddy Linda E
Subject: RE: SILO MEETING

Gary just informed me that the Joint Briefing was set for the 20th of November by he and Eric today, as apparently they would like to get this on the schedule as soon as possible.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Wednesday, October 29, 2003 4:19 PM
To: Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B; Claytor Paul; DeNard Paul D; Zelnik Jonathan R; O'Connor David F P; Lay Matthew W; Setzer Theodore D
Cc: Snoddy Linda E
Subject: SILO MEETING

I would like to schedule a conference call for early next week to discuss next steps.

Given the number of participants and travel schedule, I would also suggest that we should at this time target a date for a joint briefing with Treasury.

Please consider November 20 or, more likely, December 4. Gary informs me that these are the two best alternatives before the new year, and I believe that we do not want to wait that long.

Please respond to Linda on conference call availability and your availability to attend either on the 20th or the 4th.

NJD

Blum Steven H

From: Mattson Cynthia J
Sent: Thursday, October 09, 2003 5:37 AM
To: Blum Steven H; Grimm Danielle M; Kastl Robert J; Knapp Nancy V
Subject: RE: Summary of SILO Joint-Briefing - October 8, 2003

Thanks - excellent summary

-----Original Message-----

From: Blum Steven H
Sent: Wednesday, October 08, 2003 4:19 PM
To: Grimm Danielle M; Mattson Cynthia J; Kastl Robert J; Knapp Nancy V
Subject: Summary of SILO Joint-Briefing - October 8, 2003

Confidential: Attorney-Client Privileged Communication

Here is a brief summary of key points from today's SILO joint-briefing. I hope it is helpful to you.

5-

Grice-Winston Cozet

From: LaBelle Peter J
Sent: Thursday, September 16, 2004 6:18 PM
To: Grimm Danielle M
Subject: RE: SILO Meeting

Just to give you a quick summary, [REDACTED] Cary Allen and Diane Mirabito explained SILOs to a team of four Appeals officers and then asked for some feedback. T [REDACTED] 65

[REDACTED] That's where it was left.

Peter J. LaBelle
Deputy Division Counsel
Phone (202) 283-[REDACTED]
Fax (202) 283-7176 56

-----Original Message-----

From: Grimm Danielle M
Sent: Tuesday, September 14, 2004 11:30 AM
To: LaBelle Peter J
Subject: SILO Meeting

I rec'd your voicemail about a meeting re SILOs on Thursday. I can't seem to reach you so I thought I would send an email. I don't know anything about a meeting on Thursday. I don't have an invite on my calendar.

Danielle M. Grimm
Senior Legal Counsel
(Tax Shelters), CC:LM
202-283-[REDACTED]
Fax 202-283-7176 56

Grice-Winston Cozet

From: LaBelle Peter J
Sent: Wednesday, August 18, 2004 2:27 PM
To: Connelly Edward W
Cc: Barral Roland; Graziano Peter J; Knapp Nancy V; Dunnigan Abigail Foster; Petronchak Kathy K; Mattson Cynthia J; Zelnik Jonathan R; Russ Cary; Grimm Danielle M; Camper Diane L; Mirabito Diane R; Tancer Jody S
Subject: RE: SILO Issue Management Team (IMT)

Ned,

There was some mis-communication on this IMT. Entirely my fault. The LMSB counsel representative is Diane Mirabito. Sorry for the confusion.

Peter J. LaBelle
Deputy Division Counsel
Phone (202) 283- [REDACTED]
Fax (202) 283-7176

56

-----Original Message-----

From: Grimm Danielle M
Sent: Friday, August 13, 2004 1:31 PM
To: Connelly Edward W; Camper Diane L
Cc: Barral Roland; Graziano Peter J; Knapp Nancy V; Dunnigan Abigail Foster; Petronchak Kathy K; LaBelle Peter J; Mattson Cynthia J; Zelnik Jonathan R; Russ Cary
Subject: SILO Issue Management Team (IMT)
Importance: High

Ned,

At the SILO meeting held on Wednesday, August 11th, a decision was made to establish an IMT. Counsel was asked to provide names of representatives to be a part of this team. The LMSB field counsel will be Abbie Dunnigan-Foster. The National Office representative will be Jonathan Zelnik. Please contact Jon and Abbie once you decide when these meetings will commence. Thanks.

Danielle M. Grimm
Senior Legal Counsel
(Tax Shelters), CC:LM
202-283- [REDACTED]
Fax 202-283-7176

56

Grice-Winston Cozet

From: Barral Roland
Sent: Tuesday, July 20, 2004 10:06 AM
To: &LM All AC; &LM All MGRS
Cc: Korb Donald L; Rocen Donald L; O'Connor David F P; Zelnik Jonathan R; Pugh Cary D; Mirabito Diane R; Dunnigan Abigail Foster; DeNard Paul D; Shott Barry
Subject: Coordination of SILO Cases

As you know, Paul DeNard, Financial Services Industry Director, is the SILO Champion. As such, I serve as his primary counsel on SILO matters. Much is in the works for SILOs. A CIP, followed by an ASG are expected in the very near future.

[REDACTED]

[REDACTED]

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To assist us, please notify Associate Area Counsel (IP) Peter Graziano via e-mail of any known SILOs in your group/Area. Moreover, please keep Peter posted of any major developments, anticipated movement from examination to appeals, any settlement gestures, and any contact with an external coalition groups.

Within Area 1, review of all SILO matters is being consolidated under Peter Graziano.

Roland Barral
Area Counsel
Financial Services, LMSB

Grice-Winston Cozet

From: LaBelle Peter J
Sent: Friday, December 10, 2004 3:44 PM
To: Barral Roland; Graziano Peter J; Grimm Danielle M; Mirabito Diane R; Dunnigan Abigail Foster
Subject: FW: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

Finally.

Peter J. LaBelle
Acting Division Counsel
Phone - (202) 283- [REDACTED]
Fax - (202) 283-7176

-----Original Message-----

From: Crisalli Donna M
Sent: Friday, December 10, 2004 2:43 PM
To: Zelnik Jonathan R; &FIP REVIEW; Alexander William D; Allison Jeffrey C; Arndt Melissa D; Ashford Tamara W; Blaine George J; Brown Robert M; Butler Deborah A; Campbell Carol A; Cohen Edward S; DeNovio Nicholas J; Erickson Robert A; Evans Camille B; Fayne Denise S; Geier Janice B; Goldstein Allen; Hicks Hal; Hubbard Helen - OTP; Ingram Sarah H; Kalzen Mark S; Korb Donald L; LaBelle Peter J; Maloy Heather; Mamo Paul J; Marks Nancy J; Munroe David; Musher Steven A; Olson Nina E; Paris Dominic A; Pugh Cary D; Rocen Donald T; Ryan Diane AP; Schneiderman Henry S; Solomon Louis M; Terry Thomas D; Thoma Nancy A; Thomas Thomas R (Division Counsel); Todd Richard W; Turner Shar B; Wall Judith M
Cc: Ackerman Jonathan - OTP; Aramburu John M; Young Donna Marie
Subject: Green sheet circulation: notice designating sale-in sale-out transactions as listed transactions

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions. Comments are requested by COB December 17.



SILO Notice Green
12-10-04.doc...



SILO Notice
xecutive Summary .

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622- [REDACTED]

Grice-Winston Cozet

From: Arndt Melissa D
Sent: Friday, December 10, 2004 4:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04

This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

THE ATTACHED DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE. YOU ARE HEREBY NOTIFIED THAT ANY DISCLOSURE, COPYING, OR DISTRIBUTION, OR THE TAKING OF ANY ACTION IN RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS OFFICIAL POSITIONS OF THE IRS.



SILO Notice Green
12-10-04.doc...

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

Message

Grice-Winston Cozet

From: Arndt Melissa D
Sent: Friday, December 17, 2004 12:43 PM
To: Petronchak Kathy K; O'Donnell Douglas W; Grimm Danielle M
Subject: FW: SILO listing -- [REDACTED]

FYI

Melissa D. Arndt
 Large & Mid-Size Business Division
 Senior Legal Counsel (Research & Planning)
 Phone: (202) 283-[REDACTED]
 Fax: (202) 283-7176

b6

-----Original Message-----

From: Ingram Sarah H [mailto:Sarah.H.Ingram@irs.gov]
Sent: Friday, December 17, 2004 12:39 PM
To: Ashford Tamara W; Klotsche John C; Schwimmer Mark I; Crisalli Donna M; Zelnik Jonathan R; Ackerman Jonathan - OTP
Cc: Arndt Melissa D; Brown Robert M; Geier Janice B; Young Donna Marie; Terry Thomas D; Miller Steven T; Munroe David; Marks Nancy J; Ingram Sarah H; Hubbard Helen - OTP
Subject: SILO listing -- [REDACTED]

TF/GE Division hereby comments on the draft listing of the SILO transaction. [REDACTED]

b5

Grice-Winston Cozet

From: Arndt Melissa D
Sent: Monday, December 20, 2004 3:53 PM
To: &LM All IP; &LM Shelters; Allen Cary D; McClanahan III Frank C; Mirabito Diane R; Liberator Amy; Winters Michael A; Petronchak Kathy K; O'Donnell Douglas W; Grimm Danielle M; Arndt Melissa D
Cc: LaBelle Peter J; Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Attached is a revised draft of the SILO Notice showing changes from the green sheet copy.



SILO Notice
Clearance 12-20-04..

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

-----Original Message-----

From: Aramburu John M
Sent: Monday, December 20, 2004 1:46 PM
To: Crisalli Donna M; Arndt Melissa D
Cc: Blaine George J; O'Connor David F P; Zelnik Jonathan R
Subject: RE: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa,

Thanks to all who commented. I am responding to your request that we notify you of how the comments were handled.

55

Should I send you or someone else at Division Counsel a draft that incorporates adopted changes?

John Aramburu
Senior Counsel
CC:ITA:5
2- [REDACTED]

b6

-----Original Message-----

From: Crisalli Donna M
Sent: Tuesday, December 14, 2004 8:49 AM
To: Arndt Melissa D
Cc: Blaine George J; Aramburu John M
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Melissa, thanks for your comment. I am forwarding your email to George and John who have worked on the substance of the notice and who will be able to respond to you. Jon Zelnik's office has also been very hands-on. On this particular project I'm functioning as the paralegal.

Donna M. Crisalli
Special Counsel (ITA)
Room 4050
(202) 622-[REDACTED]

b6

-----Original Message-----

From: Arndt Melissa D
Sent: Monday, December 13, 2004 6:29 PM
To: Crisalli Donna M
Cc: Arndt Melissa D
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Donna -- I am forwarding some comments on the SILO Listing Notice. LMSB is very interested in this notice and I anticipate that there will be additional comments which I will forward on as I receive them. Would you send an e-mail letting me know the disposition of these comments so that I can share that information with the relevant people?

<<Message: FW: CIRC. -- SILO Listing Notice -- 12/18/04 >> Thanks,

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-[REDACTED]
Fax: (202) 283-7176

b6

-----Original Message-----

From: McClanahan III Frank C
Sent: Monday, December 13, 2004 8:40 AM
To: Arndt Melissa D
Cc: Dow Harmon B
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Hi Melissa. I have some comments on the Notice. [REDACTED]

b5

-----Original Message-----

From: Dow Harmon B
Sent: Friday, December 10, 2004 4:25 PM
To: William Merkle (Merkle William G); Benjamin De Luna (De Luna Benjamin A); Fried Clint M (Clint.M.Fried@IRSCOUNSEL.TREAS.GOV); James Lanning (James.C.Lanning@IRSCOUNSEL.TREAS.GOV); Gannon Richard H (Richard.H.Gannon@IRSCOUNSEL.TREAS.GOV); Bob Shilliday Jr (Shilliday Robert Jr J); Steven Guest (Guest Steven R); Vicki Hyche (Hyche Vicki J); Rogelio Villagellu (Villagellu Rogelio A); Dow Harmon B; Barry William F (William.F.Barry@IRSCOUNSEL.TREAS.GOV); Michael Calabrese (Calabrese Michael J); Carol McClure (Carol.B.McClure@IRSCOUNSEL.TREAS.GOV); Frank McClanahan (Frank.C.McClanahanIII@IRSCOUNSEL.TREAS.GOV); Sergio Garcia-Pages (Garcia-Pages Sergio); Gray James E (James.E.Gray@IRSCOUNSEL.TREAS.GOV); James Cascino (James.M.Cascino@IRSCOUNSEL.TREAS.GOV); Kirk Chaberski (Kirk.S.Chaberski@IRSCOUNSEL.TREAS.GOV); Patricia Taylor (Taylor Patricia Y); Andrew Tiktin (Tiktin Andrew M)
Subject: FW: CIRC. -- SILO Listing Notice -- 12/18/04

Report time on this into the following techmis file:
 2004-2005 Published Guidance Notice Review -- NOT-153578-04 wli 3

-----Original Message-----

From: Arndt Melissa D
Sent: Friday, December 10, 2004 3:27 PM
To: &LM PG Circ; &LM Shelters
Subject: CIRC. -- SILO Listing Notice -- 12/18/04


This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and designates SILOs as listed transactions.

Please provide your comments by December 17, 2004.

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RELIANCE ON THE CONTENTS OF THIS INFORMATION IS STRICTLY PROHIBITED. THE POSITIONS SET FORTH IN THIS DOCUMENT SHOULD NOT BE INTERPRETED AS OFFICIAL POSITIONS OF THE IRS.

<<File: SILO Notice Green 12-10-04.doc >>

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

56

Grice-Winston Cozet

From: Arndt Melissa D
Sent: Wednesday, December 22, 2004 1:29 PM
To: &LM PG Circ
Cc: &LM Shelters
Subject: FW: SILO Notice

FYI

Melissa D. Arndt
Large & Mid-Size Business Division
Senior Legal Counsel (Research & Planning)
Phone: (202) 283-
Fax: (202) 283-7176

66

-----Original Message-----

From: Fahey Douglas A
Sent: Wednesday, December 22, 2004 12:14 PM
To: Ackerman Jonathan - OTP; Ashford Tamara W
Cc: Hubbard Helen - OTP; DeNovio Nicholas J; Brown Robert M; Blaine George J; Crisalli Donna M; Arndt Melissa D; Zelnik Jonathan R
Subject: SILO Notice

The attached proposed notice has been approved by CC:ITA and has been submitted to the Chief Counsel for approval.



SILO Notice
Clearance.doc (56 ..xecutive Summary .

66

Doug Fahey
622-

Grice-Winston Cozet

From: Barral Roland
Sent: Wednesday, February 16, 2005 10:27 AM
To: Knapp Nancy V; Grimm Danielle M; LaBelle Peter J
Cc: Aramburu John M; Blume Arlene A; Brown Robert M; O'Connor David F P; Zelnik Jonathan R; Lee Shirley S; Whiteaker Stephen C; Claybough Cheryl P; O'Donnell Douglas W; Petronchak Kathy K; Shott Barry; DeNard Paul D; Graziano Peter J; Martin Robert A
Subject: RE: SILO Listing Notice - 2/11/05 - Related CIP

Yesterday, Jon Zelnik and Peter Graziano discussed the status of the CIP and Zelnik reported that there are only minor tweaks needed to the CIP to accommodate some minor changes made by Treasury to the listing notice. Zelnik reported that Dave O'Connor is working on this and it should not be much longer. [REDACTED]

[REDACTED] This should free up John Aramburu so that he can resume his traditional duties. Abby Dunnigan and Tom Kerrigan will take over Diane Mirabito's work on LILOs and SILOs. The Chief Counsel was very pleased with Diane's assignment.

53/
6103
35

-----Original Message-----

From: Knapp Nancy V
Sent: Wednesday, February 16, 2005 10:12 AM
To: Grimm Danielle M; LaBelle Peter J
Cc: Aramburu John M; Blume Arlene A; Brown Robert M; O'Connor David F P; Zelnik Jonathan R; Lee Shirley S; Whiteaker Stephen C; Claybough Cheryl P; O'Donnell Douglas W; Petronchak Kathy K; Shott Barry; DeNard Paul D; Graziano Peter J; Martin Robert A; Barral Roland
Subject: SILO Listing Notice - 2/11/05 - Related CIP

Danielle and Peter,

I made a few inquiries about the SILO CIP yesterday morning, in preparation for an afternoon presentation at the banking subindustry meeting. You may recall that the draft CIP was suspended until issuance of the listing notice. I will ask TSS4510 to restore the assignment to active status.

My understanding is the CIP should be through N.O. review in the next few weeks. Barry Shott showed me a blackberry message yesterday in which Peter Graziano informed him that Jon Zelnik estimated completion of N.O. review by the end of next week. At about the same time, John Arambaru in CC:ITA informed me that he should be able to get to the CIP in a week or two. John explained that the CIP [REDACTED]

[REDACTED] John appreciates the high priority but noted that he has his hands full in [REDACTED] and doing work on the pending FOIA suit relating to LILOs.

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53/610

I've also had inquiries about the CIP from Cheryl Claybough and Shirley Lee. I gave Cheryl a two-week estimate but noted that the CIP will then have to go through the LMSB final clearance process. That process includes sign-off by the industry directors and several executives plus release of the document to the Hill. That work is shepherded by Shirley Lee and normally takes in excess of 30 days. I will work with Shirley to expedite that process as much as possible.

-----Original Message-----

From: Grimm Danielle M
Sent: Tuesday, February 15, 2005 12:01 PM
To: &LM HQ Employees; &LM Shelters

Grice-Winston Cozet

From: Blum Steven H
Sent: Friday, January 16, 2004 3:21 PM
To: Grimm Danielle M; Mattson Cynthia J
Subject: FW: SILO Notice 1-16-04.doc



SILO Notice
-16-04.doc (118 K.1-16-04 (checked)...
FYI.

-----Original Message-----

From: DeNovio Nicholas J
Sent: Friday, January 16, 2004 3:20 PM
To: Mirabito Diane R; Allen Cary D; Prager JoAnn; Aramburu John M; Shatz Eileen M; Blum Steven H; Stevens Matthew A; Pugh Cary D
Cc: Lay Matthew W; Zelnik Jonathan R
Subject: FW: SILO Notice 1-16-04.doc

Latest draft. Please forward within your offices/groups.

Comments to Matt Lay please by Wednesday January 21.

Thanks.

Cc: Dever James P; Avazian Andrea D; Jallade Louis E; Misir Bisamber; Patel Debbie J; Desousa Brian J
Subject: SILO Listing Notice - 2/11/05

<< File: silo notice.RTF >>

You may have already seen this but thought it worth circulating.

A new listing notice was issued on Friday, 2/11/05 (Notice 2005-13) for transactions commonly referred to as SILOs.

Grice-Winston Cozet

From: Blum Steven H
Sent: Monday, November 03, 2003 8:29 AM
To: Grimm Danielle M
Subject: RE: SILO MEETING

Hi Danielle.

I contacted Linda Snoddy and asked to be included in both. I told her I could be available at Nick's convenience for both meetings. I have yet to hear of a meeting time for the conference call, but have the joint-briefing on my calendar. I will contact Linda this morning to see about whether a conference call has been scheduled. Not having attended a joint-briefing in the past, is there something I should be doing to prepare for this?

Thank you for any information you can provide.

Regards,

Steve Blum
X3- [REDACTED]

b6

-----Original Message-----

From: Grimm Danielle M
Sent: Friday, October 31, 2003 5:18 PM
To: Blum Steven H
Subject: RE: SILO MEETING

Steve, I assume you will continue to carry this matter for HQ ? Will you be participating in the call and briefing ?

-----Original Message-----

From: DeNovio Nicholas J
Sent: Wednesday, October 29, 2003 4:19 PM
To: Allen Cary D; Prager JoAnn; Blum Steven H; Mirabito Diane R; Graziano Peter J; Brown Robert M; Jackson William A; Schwartz Edward C; Shatz Eileen M; Blaine George J; Aramburu John M; Tancer Jody S; Mattson Cynthia J; Grimm Danielle M; Baker Mary B; Claytor Paul; DeNard Paul D; Zelnik Jonathan R; O'Connor David F P; Lay Matthew W; Setzer Theodore D
Cc: Snoddy Linda E
Subject: SILO MEETING

I would like to schedule a conference call for early next week to discuss next steps.

Given the number of participants and travel schedule, I would also suggest that we should at this time target a date for a joint briefing with Treasury.

Please consider November 20 or, more likely, December 4. Gary informs me that these are the two best alternatives before the new year, and I believe that we do not want to wait that long.

Please respond to Linda on conference call availability and your availability to attend either on the 20th or the 4th.

NJD

Grice-Winston Cozet

From: Blum Steven H
Sent: Monday, October 27, 2003 10:14 AM
To: Grimm Danielle M
Subject: RE: SILO

Hi Danielle.

Below, please find a draft which I hope incorporates what you need. I called Diane Mirabito to ask her to send me a list of the shelter task force members. I've never received any information about this task force, other than our initial discussions that you wanted me to participate. I also asked Debbie Patel and Mary Baker to provide me with the summaries of the transaction they used for the Commissioner's briefing book. If any of these people get back to me, I will update this for you. In the meantime, I wrote up a short summary, that gives you what I understand to be the basics. I hope this is useful to you. Please let me know if you have questions.

Best regards,

Steve Blum
X3-8627

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Task Force: Steve Blum, CC:LM
Diane Mirabito, LM
Joanne Prager, PFTG
Cary Allen, LMSB
Pat Autry, LMSB
Peter Graziano, LM
Jody Tancer, LM
Paul DeNard, LMSB
Robert Brown, ITA
William Jackson, ITA
Edward Schwartz, ITA
John Aramburu, ITA
Eileen Schatz, PSI
George Blaine, PA

Associate Contacts:

-- Briefing w Treasury on 10/8/2003 and others held to discuss legal issues and impact.
Nick's office working w Treasury to develop appropriate legal arguments to advance in
these cases. There are some particular concerns about [REDACTED]

65

-----Original Message-----

From: Grimm Danielle M
Sent: Friday, October 24, 2003 6:24 PM
To: Blum Steven H
Subject: SILO

Steve,

Can you please fill in the names of the other Task Force members and include a brief description of the transaction (s) (no longer than 2/3 of a page). This will become part of a record that I maintain on emerging issues and the information may also be placed on the OTSA website. Before that happens, though, we will pass the description by Cary and Diane. I know that a description was included in the SFC Hearing Prep Book. Perhaps you should simply drop that in. You may need to ask Mary Baker or Debbie Patel for the electronic copy of that. Please also include the date of the SILO Briefing and any additional information. Please also list the Associate Offices involved and the names of the specific individuals involved. Can you complete this on Monday or Tuesday ??

1. Sale In Lease Out

Task Force: Steve Blum, CC:LM
Diane Mirabito, LM
Joanne Prager, PFTG
Cary Russ

Associate Contacts:


- Briefing w Treasury and others held to discuss legal issues and impact.
Nick's office working w Treasury to develop appropriate legal arguments to advance
in these cases. [REDACTED] 55

Danielle M. Grimm
Senior Legal Counsel
(Tax Shelters), CC:LM
202-283-[REDACTED]
Fax 202-283-7176 56

Grice-Winston Cozet

From: Prager JoAnn [JoAnn.Prager@irs.gov]
Sent: Wednesday, August 06, 2003 5:07 PM
To: Grimm Danielle M
Cc: Autry Patricia J; Allen Cary D
Subject: Silo

Here's some SILO info. You can talk to Pat Autry or Cary Allen. In addition there was a brief write up in the info that I sent you with the emerging issues. It was part of a larger write up for Deb Nolan.

Jo Ann Prager
Manager, LMSB: Prefiling and Technical Guidance
Telephone and VMS: 202-283-
FAX: 202-283-8406

56

Grice-Winston Cozet

From: Allen Cary D [Cary.Allen@irs.gov]
Sent: Friday, June 06, 2003 12:02 PM
To: Pugh Cary D
Cc: Prager JoAnn; Grimm, Danielle M; O'Connor David F P; DeNovio Nicholas J; Clark Ken S
Subject: FW: SILOs

Cary VA,

LS

CDA

Note to Ken Clark:

Please add any comments on the current work or clarify any of my comments. Send them to Cary D. Pugh. Copy Nick, Dave and Danielle.

CDA



Proforma comments
for checkshe...

-----Original Message-----

From: Prager JoAnn
Sent: Friday, June 06, 2003 10:44 AM
To: Allen Cary D
Subject: FW: SILOs

Jo Ann Prager

Manager, LMSB: Prefiling and Technical Guidance
Telephone and VMS: 202-283-[REDACTED]
FAX: 202-283-8406

-----Original Message-----

From: O'Connor David F P [<mailto:David.F.P.O'Connor@irsounsel.treas.gov>]
Sent: Friday, June 06, 2003 10:09 AM
To: Pugh Cary D; Grimm Danielle M; DeNovio Nicholas J
Cc: Prager JoAnn
Subject: RE: SILOs

Cary:

JoAnn may be your best source.

Dave

-----Original Message-----

From: Pugh Cary D
Sent: Friday, June 06, 2003 9:53 AM
To: Grimm Danielle M; O'Connor David F P; DeNovio Nicholas J
Subject: SILOs

I noticed on the OTSA list of registrations we have a category of "Leasing (Tax Exempt Entity)" -- I assume that not all of those would be SILOs would they? Can anyone help with that?

Grice-Winston Cozet

From: Lay Matthew W
Sent: Monday, February 11, 2002 11:15 AM
To: Lay Matthew W; Grimm Danielle M; Ellison Christine E; Gray Carolyn Hinchman; Shatz Eileen M
Cc: Miosi Dianna K; Yatrakis Demetri G; Hines John T
Subject: RE: SILO Notice

Please note -- the meeting described below has been rescheduled for **Tuesday, February 19 at 2 p.m.**

-----Original Message-----

From: Lay Matthew W
Sent: Tuesday, February 05, 2002 3:49 PM
To: Grimm Danielle M; Ellison Christine E; Gray Carolyn Hinchman; Shatz Eileen M
Cc: Miosi Dianna K; Yatrakis Demetri G
Subject: RE: SILO Notice

As you know, LILO (Lease-in, Lease-out) transactions have largely been replaced by sale-in, lease-out transactions.

Branch 2 has prepared a draft Notice that would add these sale-in, lease-out transactions into "listed transactions" for purposes of the tax shelter registration rules.

We will be briefing the front office on our draft Notice on Feb 15 at 2:30. Please join us if you are interested. We will distribute a copy of the Notice prior to the meeting.

-----Original Message-----

From: Yatrakis Demetri G
Sent: Tuesday, February 05, 2002 2:14 PM
To: Lay Matthew W
Subject: RE: SILO Notice

We are scheduled on Feb 15th 2:30-4:30. I invited the front office.

-----Original Message-----

From: Lay Matthew W
Sent: Tuesday, February 05, 2002 12:24 PM
To: Yatrakis Demetri G
Subject: SILO Notice

Please try to reserve about 2 hours with Paul regarding the SILO Notice towards the end of next week or later? If he has no time that week I am out on Friday Feb 22 and Monday Feb 18 is a holiday.

Matthew Lay
Senior Technician Reviewer
CC:PSI:2
Room 5011
(202) 622-

56

Grice-Winston Cozet

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Matthew Lay
Senior Technician Reviewer
CC:PSI:2
Room 5011
(202) 622- [REDACTED]

56

Grice-Winston Cozet

From: Blum Steven H
Sent: Wednesday, November 19, 2003 4:54 PM
To: Ng Frank Y
Cc: Grimm Danielle M; Mattson Cynthia J
Subject: SILO Legislation

Frank:

Here is the draft legislation on SILOs you asked about earlier. I believe it largely attacks t [REDACTED] of SILOS. b5

I hope this is helpful to you.

Regards,

Steve Blum
(202) 283- [REDACTED] b6

The JOBS Act has two different provisions (section 472 and section 476) that would restrict the tax benefits of SILOs. I have attached the Bill (S. 1637) along with excerpts from the Senate Finance Committee explanation.



s1637rs.pdf (875 KB)



s1637rs.pdf (875 KB)

Calendar No. 381

108TH CONGRESS
1ST SESSION**S. 1637**

[Report No. 108-192]

To amend the Internal Revenue Code of 1986 to comply with the World Trade Organization rulings on the FSC/ETI benefit in a manner that preserves jobs and production activities in the United States, to reform and simplify the international taxation rules of the United States, and for other purposes.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 18, 2003

Mr. FRIST (for Mr. GRASSLEY) (for himself, Mr. BAUCUS, Mr. HATCH, Mr. GRAHAM of Florida, Mr. SMITH, Mr. DASCHLE, Mrs. MURRAY, Ms. CANTWELL, and Mr. CHAFEE) introduced the following bill; which was read twice and referred to the Committee on Finance

NOVEMBER 7, 2003

Reported by Mr. GRASSLEY, with an amendment

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To amend the Internal Revenue Code of 1986 to comply with the World Trade Organization rulings on the FSC/ETI benefit in a manner that preserves jobs and production activities in the United States, to reform and simplify the international taxation rules of the United States, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
 2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE;**
 4 **TABLE OF CONTENTS.**

5 (a) **SHORT TITLE.**—This Act may be cited as the
 6 “Jumpstart Our Business Strength (JOBS) Act”.

7 (b) **AMENDMENT OF 1986 CODE.**—Except as other-
 8 wise expressly provided, whenever in this Act an amend-
 9 ment or repeal is expressed in terms of an amendment
 10 to, or repeal of, a section or other provision, the reference
 11 shall be considered to be made to a section or other provi-
 12 sion of the Internal Revenue Code of 1986.

13 (c) **TABLE OF CONTENTS.**—

Sec. 1. Short title; amendment of 1986 Code; table of contents.

**TITLE I—PROVISIONS RELATING TO REPEAL OF EXCLUSION FOR
 EXTRATERRITORIAL INCOME**

Sec. 101. Repeal of exclusion for extraterritorial income.

Sec. 102. Deduction relating to income attributable to United States production
 activities.

TITLE II—INTERNATIONAL TAX PROVISIONS

Subtitle A—International Tax Reform

Sec. 201. 20-year foreign tax credit carry-forward.

Sec. 202. Look-thru rules to apply to dividends from noncontrolled section 902
 corporations.

Sec. 203. Foreign tax credit under alternative minimum tax.

Sec. 204. Rec characterization of overall domestic loss.

Sec. 205. Interest expense allocation rules.

Sec. 206. Determination of foreign personal holding company income with re-
 spect to transactions in commodities.

Subtitle B—International Tax Simplification

Sec. 211. Repeal of foreign personal holding company rules and foreign invest-
 ment company rules.

Sec. 212. Expansion of de minimis rule under subpart F.

Sec. 212. Attribution of stock ownership through partnerships to apply in determining section 902 and 960 credits.
Sec. 214. Application of uniform capitalization rules to foreign persons.
Sec. 215. Repeal of withholding tax on dividends from certain foreign corporations.
Sec. 216. Repeal of special capital gains tax on aliens present in the United States for 153 days or more.

TITLE I—PROVISIONS RELATING TO REPEAL OF EXCLUSION FOR EXTRATERRITORIAL IN- COME

SEC. 101. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL INCOME.

(a) IN GENERAL.—Section 114 is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1)(A) Subpart E of part III of subchapter N of chapter 1 (relating to qualifying foreign trade in- come) is hereby repealed.

(B) The table of subparts for such part III is amended by striking the item relating to subpart E.

(2) The table of sections for part III of subchapter B of chapter 1 is amended by striking the item relating to section 114.

(3) The second sentence of section 56(g)(1)(B)(i) is amended by striking “or under sec-

tion 114.”

(4) Section 275(a) is amended—

(A) by inserting “or” at the end of para-

graph (1)(A), by striking “or” at the end of

1 paragraph (4)(B) and inserting a period, and
 2 by striking subparagraph (C), and

3 (B) by striking the last sentence.

4 (5) Paragraph (3) of section 864(e) is amend-
 5 ed—

6 (A) by striking:

7 “(3) TAX-EXEMPT ASSETS NOT TAKEN INTO
 8 ACCOUNT.—

9 “(A) IN GENERAL.—For purposes of”, and
 10 inserting:

11 “(3) TAX-EXEMPT ASSETS NOT TAKEN INTO
 12 ACCOUNT.—For purposes of”, and

13 (B) by striking subparagraph (B).

14 (6) Section 903 is amended by striking “114,
 15 164(a),” and inserting “164(a)”.

16 (7) Section 999(e)(1) is amended by striking
 17 “941(a)(5),”.

18 (e) EFFECTIVE DATE.—

19 (1) IN GENERAL.—The amendments made by
 20 this section shall apply to transactions occurring
 21 after the date of the enactment of this Act.

22 (2) BINDING CONTRACTS.—The amendments
 23 made by this section shall not apply to any trans-
 24 action in the ordinary course of a trade or business
 25 which occurs pursuant to a binding contract—

1 (A) which is between the taxpayer and a
2 person who is not a related person (as defined
3 in section 943(b)(2) of such Code, as in effect
4 on the day before the date of the enactment of
5 this Act), and
6 (B) which is in effect on September 17,
7 2002, and at all times thereafter:
8 (d) REVOCATION OF SECTION 943(c) ELECTIONS.—
9 (1) IN GENERAL.—In the case of a corporation
10 that elected to be treated as a domestic corporation
11 under section 943(c) of the Internal Revenue Code
12 of 1986 (as in effect on the day before the date of
13 the enactment of this Act)—
14 (A) the corporation may, during the 1-year
15 period beginning on the date of the enactment
16 of this Act, revoke such election, effective as of
17 such date of enactment, and
18 (B) if the corporation does revoke such
19 election—
20 (i) such corporation shall be treated
21 as a domestic corporation transferring (as
22 of such date of enactment) all of its prop-
23 erty to a foreign corporation in connection
24 with an exchange described in section 354
25 of such Code, and

1 (ii) no gain or loss shall be recognized
 2 on such transfer.
 3 (2) EXCEPTION.—Subparagraph (B)(ii) of
 4 paragraph (1) shall not apply to gain on any asset
 5 held by the revoking corporation if—
 6 (A) the basis of such asset is determined
 7 in whole or in part by reference to the basis of
 8 such asset in the hands of the person from
 9 whom the revoking corporation acquired such
 10 asset;
 11 (B) the asset was acquired by transfer (not
 12 as a result of the election under section 943(c)
 13 of such Code) occurring on or after the 1st day
 14 on which its election under section 943(c) of
 15 such Code was effective; and
 16 (C) a principal purpose of the acquisition
 17 was the reduction or avoidance of tax (other
 18 than a reduction in tax under section 114 of
 19 such Code, as in effect on the day before the
 20 date of the enactment of this Act).
 21 (c) GENERAL TRANSITION.—
 22 (1) IN GENERAL.—In the case of a taxable year
 23 ending after the date of the enactment of this Act
 24 and beginning before January 1, 2007, for purposes
 25 of chapter 1 of such Code, a current PSC/ETI bene-

1 beneficiary shall be allowed a deduction equal to the

2 transition amount determined under this subsection

3 with respect to such beneficiary for such year.

4 (2) CURRENT FSC/ETI BENEFICIARY.—The

5 term “current FSC/ETI beneficiary” means any cor-

6 poration which entered into one or more transactions

7 during its taxable year beginning in calendar year

8 2002 with respect to which FSC/ETI benefits were

9 allowable.

10 (3) TRANSITION AMOUNT.—For purposes of

11 this subsection—

12 (A) IN GENERAL.—The transition amount

13 applicable to any current FSC/ETI beneficiary

14 for any taxable year is the phaseout percentage

15 of the base period amount.

16 (B) PHASEOUT PERCENTAGE.—

17 (i) IN GENERAL.—In the case of a

18 taxpayer using the calendar year as its

19 taxable year, the phaseout percentage shall

20 be determined under the following table:

The phaseout	
percentage is:	
Years:	
2004	80
2005	80
2006	80

21 (ii) SPECIAL RULE FOR 2003.—The

22 phaseout percentage for 2003 shall be the

23 amount that bears the same ratio to 100

1 percent as the number of days after the
 2 date of the enactment of this Act bears to
 3 365.

4 (iii) SPECIAL RULE FOR FISCAL YEAR
 5 TAXPAYERS.—In the case of a taxpayer
 6 not using the calendar year as its taxable
 7 year, the phaseout percentage is the
 8 weighted average of the phaseout percent-
 9 ages determined under the preceding provi-
 10 sions of this paragraph with respect to cal-
 11 endar years any portion of which is in-
 12 cluded in the taxpayer's taxable year. The
 13 weighted average shall be determined on
 14 the basis of the respective portions of the
 15 taxable year in each calendar year.

16 (4) BASE PERIOD AMOUNT.—For purposes of
 17 this subsection, the base period amount is the aggre-
 18 gate FSC/ETI benefits for the taxpayer's taxable
 19 year beginning in calendar year 2002.

20 (5) FSC/ETI BENEFIT.—For purposes of this
 21 subsection, the term "FSC/ETI benefit" means—

22 (A) amounts excludable from gross income
 23 under section 114 of such Code, and

24 (B) the exempt foreign trade income of re-
 25 lated foreign sales corporations from property

1 acquired from the taxpayer (determined without
2 regard to section 923(a)(5) of such Code (relat-
3 ing to special rule for military property), as in
4 effect on the day before the date of the enact-
5 ment of the FSC Repeal and Extraterritorial
6 Income Exclusion Act of 2000).
7 In determining the FSC/ETI benefit there shall be
8 excluded any amount attributable to a transaction
9 with respect to which the taxpayer is the lessor un-
10 less the leased property was manufactured or pro-
11 duced in whole or in part by the taxpayer.
12 (6) SPECIAL RULE FOR FARM COOPERATIVES.—
13 Determinations under this subsection with respect to
14 an organization described in section 943(g)(1) of
15 such Code, as in effect on the day before the date
16 of the enactment of this Act, shall be made at the
17 cooperative level and the purposes of this subsection
18 shall be carried out in a manner similar to section
19 250(h) of such Code, as added by this Act. Such de-
20 terminations shall be in accordance with such re-
21 quirements and procedures as the Secretary may
22 prescribe.
23 (7) CERTAIN RULES TO APPLY.—Rules similar
24 to the rules of section 41(f) of such Code shall apply
25 for purposes of this subsection.

(8) COORDINATION WITH BINDING CONTRACT
 RULE.—The deduction determined under paragraph
 (1) for any taxable year shall be reduced by the
 phaseout percentage of any FSC/ETI benefit real-
 ized for the taxable year by reason of subsection
 (c)(2), except that for purposes of this paragraph
 the phaseout percentage for 2003 shall be treated as
 being equal to 100 percent.

(9) SPECIAL RULE FOR TAXABLE YEAR WHICH
 INCLUDES DATE OF ENACTMENT.—In the case of a
 taxable year which includes the date of the enact-
 ment of this Act, the deduction allowed under this
 subsection to any current FSC/ETI beneficiary shall
 in no event exceed—

(A) 100 percent of such beneficiary's base
 period amount for calendar year 2003, reduced
 by

(B) the aggregate FSC/ETI benefits of
 such beneficiary with respect to transactions oc-
 curring during the portion of the taxable year
 ending on the date of the enactment of this Act.

1 **SEC. 102. DEDUCTION RELATING TO INCOME ATTRIB-**
 2 **UTABLE TO UNITED STATES PRODUCTION**
 3 **ACTIVITIES.**

4 **(a) IN GENERAL.**—Part VIII of subchapter B of
 5 chapter 1 (relating to special deductions for corporations)
 6 is amended by adding at the end the following new section:
 7 **“SEC. 250. INCOME ATTRIBUTABLE TO DOMESTIC PRODUC-**
 8 **TION ACTIVITIES.**

9 **“(a) IN GENERAL.**—In the case of a corporation,
 10 there shall be allowed as a deduction an amount equal to
 11 9 percent of the qualified production activities income of
 12 the corporation for the taxable year.

13 **“(b) PHASEIN.**—In the case of taxable years begin-
 14 ning in 2004, 2005, 2006, 2007, or 2008, subsection (a)
 15 shall be applied by substituting for the percentage con-
 16 tained therein the transition percentage determined under
 17 the following table:

“Taxable years beginning in:	The transition percentage is:
2004	1
2005	2
2006	3
2007 or 2008	6.

18 **“(c) QUALIFIED PRODUCTION ACTIVITIES IN-**
 19 **COME.**—For purposes of this section—

20 **“(1) IN GENERAL.**—The term ‘qualified produc-
 21 tion activities income’ means an amount equal to the
 22 applicable percentage of the portion of the modified

1 taxable income of the taxpayer which is attributable
2 to domestic production activities.

3 ~~“(2) APPLICABLE PERCENTAGE.—~~For purposes
4 of this subsection, the term ‘applicable percentage’
5 means—

6 ~~“(A) in the case of taxable years beginning~~
7 ~~before 2012, a percentage equal to the domes-~~
8 ~~tic/worldwide fraction;~~

9 ~~“(B) in the case of taxable years beginning~~
10 ~~in 2012, a percentage (not greater than 100~~
11 ~~percent) equal to twice the domestic/worldwide~~
12 ~~fraction; and~~

13 ~~“(C) in the case of taxable years beginning~~
14 ~~after 2012, 100 percent.~~

15 ~~“(d) DETERMINATION OF INCOME ATTRIBUTABLE~~
16 ~~TO DOMESTIC PRODUCTION ACTIVITIES.—~~For purposes
17 of this section—

18 ~~“(1) IN GENERAL.—~~The portion of the modified
19 taxable income which is attributable to domestic pro-
20 duction activities is so much of the modified taxable
21 income for the taxable year as does not exceed—

22 ~~“(A) the taxpayer’s domestic production~~
23 ~~gross receipts for such taxable year, reduced by~~

24 ~~“(B) the sum of—~~

1 “(i) the costs of goods sold that are
2 allocable to such receipts;

3 “(ii) other deductions, expenses, or
4 losses directly allocable to such receipts,
5 and

6 “(iii) a proper share of other deduc-
7 tions, expenses, and losses that are not di-
8 rectly allocable to such receipts or another
9 class of income.

10 “(2) ALLOCATION METHOD.—The Secretary
11 shall prescribe rules for the proper allocation of
12 items of income, deduction, expense, and loss for
13 purposes of determining income attributable to do-
14 mestic production activities.

15 “(3) SPECIAL RULES FOR DETERMINING
16 COSTS.—

17 “(A) IN GENERAL.—For purposes of deter-
18 mining costs under clause (i) of paragraph
19 (1)(B), any item or service brought into the
20 United States without a transfer price meeting
21 the requirements of section 482 shall be treated
22 as acquired by purchase, and its cost shall be
23 treated as not less than its value when it en-
24 tered the United States. A similar rule shall
25 apply in determining the adjusted basis of

1 leased or rented property where the lease or
 2 rental gives rise to domestic production gross
 3 receipts.

4 ~~“(B) EXPORTS FOR FURTHER MANUFAC-~~
 5 ~~TURE.~~—In the case of any property described
 6 in subparagraph (A) that had been exported by
 7 the taxpayer for further manufacture, the in-
 8 crease in cost or adjusted basis under subpara-
 9 graph (A) shall not exceed the difference be-
 10 tween the value of the property when exported
 11 and the value of the property when brought
 12 back into the United States after the further
 13 manufacture.

14 ~~“(4) MODIFIED TAXABLE INCOME.~~—The term
 15 ‘modified taxable income’ means taxable income
 16 computed without regard to the deduction allowable
 17 under this section.

18 ~~“(e) DOMESTIC PRODUCTION GROSS RECEIPTS.~~—
 19 For purposes of this section, the term ‘domestic produc-
 20 tion gross receipts’ means the gross receipts of the tax-
 21 payer which are derived from—

22 ~~“(1) any sale, exchange, or other disposition of,~~

23 or

24 ~~“(2) any lease, rental, or license of,~~

1 qualifying production property which was manufactured,
2 produced, grown, or extracted in whole or in significant
3 part by the taxpayer within the United States:
4 ~~"(f) QUALIFYING PRODUCTION PROPERTY. For~~
5 ~~purposes of this section—~~
6 ~~"(1) IN GENERAL. Except as otherwise pro-~~
7 ~~vided in this paragraph, the term 'qualifying produc-~~
8 ~~tion property' means—~~
9 ~~"(A) any tangible personal property;~~
10 ~~"(B) any computer software; and~~
11 ~~"(C) any property described in section~~
12 ~~168(f) (2) or (4).~~
13 ~~"(2) EXCLUSIONS FROM QUALIFYING PRODU-~~
14 ~~CTION PROPERTY. The term 'qualifying production~~
15 ~~property' shall not include—~~
16 ~~"(A) consumable property that is sold,~~
17 ~~leased, or licensed by the taxpayer as an inte-~~
18 ~~gral part of the provision of services;~~
19 ~~"(B) oil or gas (or any primary product~~
20 ~~thereof;~~
21 ~~"(C) electricity;~~
22 ~~"(D) water supplied by pipeline to the con-~~
23 ~~sumer;~~
24 ~~"(E) any unprocessed timber which is~~
25 ~~softwood;~~

1 “(F) utility services, or

2 “(G) any property (not described in para-
3 graph (1)(B)) which is a film, tape, recording,
4 book, magazine, newspaper, or similar property
5 the market for which is primarily topical or oth-
6 erwise essentially transitory in nature.

7 For purposes of subparagraph (E), the term ‘un-
8 processed timber’ means any log, cant, or similar
9 form of timber.

10 “(g) DOMESTIC/~~WORLDWIDE~~ FRACTION.—For pur-
11 poses of this section—

12 “(1) IN GENERAL.—The term ‘domestic/world-
13 wide fraction’ means a fraction—

14 “(A) the numerator of which is the value
15 of the domestic production of the taxpayer, and

16 “(B) the denominator of which is the value
17 of the worldwide production of the taxpayer.

18 “(2) VALUE OF DOMESTIC PRODUCTION.—The
19 value of domestic production is the excess of—

20 “(A) the domestic production gross re-
21 cepts, over

22 “(B) the cost of purchased inputs allocable
23 to such receipts that are deductible under this
24 chapter for the taxable year.

25 “(3) PURCHASED INPUTS.—

1 ~~“(A) IN GENERAL.~~—Purchased inputs are
2 any of the following items acquired by pur-
3 chase:

4 ~~“(i) Services (other than services of~~
5 employees) used in manufacture, produc-
6 tion, growth, or extraction activities.

7 ~~“(ii) Items consumed in connection~~
8 with such activities.

9 ~~“(iii) Items incorporated as part of~~
10 the property being manufactured, pro-
11 duced, grown, or extracted.

12 ~~“(B) SPECIAL RULE.~~—Rules similar to the
13 rules of subsection (d)(2) shall apply for pur-
14 poses of this subsection.

15 ~~“(4) VALUE OF WORLDWIDE PRODUCTION.~~—

16 ~~“(A) IN GENERAL.~~—The value of world-
17 wide production shall be determined under the
18 principles of paragraph (2), except that—

19 ~~“(i) worldwide production gross re-~~
20 cepts shall be taken into account, and

21 ~~“(ii) paragraph (3)(B) shall not apply.~~

22 ~~“(B) WORLDWIDE PRODUCTION GROSS RE-~~
23 CEIPTS.—The worldwide production gross re-
24 cepts is the amount that would be determined
25 under subsection (c) if such subsection were ap-

plied without any reference to the United

States:

"(5) SPECIAL RULE FOR AFFILIATED

GROUPS.—

"(A) IN GENERAL.—In the case of a tax-

payer that is a member of an expanded affil-

ated group, the domestic/worldwide fraction

shall be the amount determined under the pre-

ceding provisions of this subsection by treating

all members of such group as a single corpora-

tion.

"(B) EXPANDED AFFILIATED GROUP.—

The term 'expanded affiliated group' means an

affiliated group as defined in section 1504(a);

determined—

"(i) by substituting '50 percent' for

'80 percent' each place it appears, and

"(ii) without regard to paragraphs

(2), (3), (4), and (8) of section 1504(b).

"(h) DEFINITIONS AND SPECIAL RULES.—

"(1) EXCLUSION FOR PATRONS OF AGRICUL-

TURAL AND HORTICULTURAL COOPERATIVES.—

"(A) IN GENERAL.—If any amount de-

scribed in paragraph (1) or (3) of section 1385

(a)—

1 "(i) is received by a person from an
2 organization to which part I of subchapter
3 F applies which is engaged in the mar-
4 keting of agricultural or horticultural prod-
5 ucts; and
6 "(ii) is allocable to the portion of the
7 qualified production activities income of
8 the organization which is deductible under
9 subsection (a) (determined as if the organi-
10 zation were a corporation if it is not) and
11 designated as such by the organization in
12 a written notice mailed to its patrons dur-
13 ing the payment period described in section
14 1382(a);
15 then such person shall be allowed an exclusion
16 from gross income with respect to such amount.
17 The taxable income of the organization shall
18 not be reduced under section 1382 by the por-
19 tion of any such amount with respect to which
20 an exclusion is allowable to a person by reason
21 of this paragraph.
22 "(B) SPECIAL RULES. For purposes of
23 applying subparagraph (A), in determining the
24 qualified production activities income of the or-
25 ganization under this section—

1 “(i) there shall not be taken into ac-
2 count in computing the organization's
3 modified taxable income any deduction al-
4 lowable under subsection (b) or (c) of sec-
5 tion 1382 (relating to patronage dividends,
6 per-unit retain allocations, and nonpatron-
7 age distributions); and
8 “(ii) the organization shall be treated
9 as having manufactured, produced, grown,
10 or extracted in whole or significant part
11 any qualifying production property mar-
12 keted by the organization which its patrons
13 have so manufactured, produced, grown, or
14 extracted:
15 “(2) SPECIAL RULE FOR PARTNERSHIPS.—For
16 purposes of this section, a corporation's distributive
17 share of any partnership item shall be taken into ac-
18 count as if directly realized by the corporation.
19 “(3) COORDINATION WITH MINIMUM TAX.—The
20 deduction under this section shall be allowed for
21 purposes of the tax imposed by section 55, except
22 that for purposes of section 55, alternative minimum
23 taxable income shall be taken into account in deter-
24 mining the deduction under this section.

1 “(4) ORDERING RULE.—The amount of any
2 other deduction allowable under this chapter shall be
3 determined as if this section had not been enacted.

4 “(5) COORDINATION WITH TRANSITION
5 RULES.—For purposes of this section—

6 “(A) domestic production gross receipts
7 shall not include gross receipts from any trans-
8 action if the binding contract transition relief of
9 section 101(e)(2) of the Jumpstart Our Busi-
10 ness Strength (JOBS) Act applies to such
11 transaction, and

12 “(B) any deduction allowed under section
13 101(e) of such Act shall be disregarded in de-
14 termining the portion of the taxable income
15 which is attributable to domestic production
16 gross receipts.”.

17 (b) DEDUCTION ALLOWED TO SHAREHOLDERS OF S
18 CORPORATIONS.—

19 (1) IN GENERAL.—Section 1363(b) (relating to
20 computation of S corporation's taxable income) is
21 amended by striking “and” at the end of paragraph
22 (3), by striking the period at the end of paragraph
23 (4) and inserting “, and”, and by adding at the end
24 the following new paragraph:

- 1 "(5) the deduction under section 250 shall be
- 2 allowed to the S corporation."
- 3 (2) INCREASE IN BASIS.—Section 1367(a)(1)
- 4 (relating to increases in basis) is amended by strike-
- 5 ing "and" at the end of subparagraph (B), by strike-
- 6 ing the period at the end of subparagraph (C) and
- 7 inserting ", and", and by adding at the end the fol-
- 8 lowing new subparagraph:
- 9 "(D) any deduction allowed under section
- 10 250."
- 11 (e) MINIMUM TAX.—Section 56(g)(4)(C) (relating to
- 12 disallowance of items not deductible in computing earnings
- 13 and profits) is amended by adding at the end the following
- 14 new clause:
- 15 "(v) DEDUCTION FOR DOMESTIC PRO-
- 16 DUCTION.—Clause (i) shall not apply to
- 17 any amount allowable as a deduction under
- 18 section 250."
- 19 (d) CLERICAL AMENDMENT.—The table of sections
- 20 for part VIII of subchapter B of chapter 1 is amended
- 21 by adding at the end the following new item:
- 22 "Sec. 250. Income attributable to domestic production activi-
- ties."
- (e) EFFECTIVE DATE.—

1 (1) IN GENERAL.—The amendments made by
 2 this section shall apply to taxable years ending after
 3 the date of the enactment of this Act.
 4 (2) APPLICATION OF SECTION 15.—Section 15
 5 of the Internal Revenue Code of 1986 shall apply to
 6 the amendments made by this section as if they were
 7 changes in a rate of tax.

8 TITLE II—INTERNATIONAL TAX

9 PROVISIONS

10 Subtitle A—International Tax

11 Reform

12 SEC. 201. 20-YEAR FOREIGN TAX CREDIT CARRYFORWARD.
 13 (a) GENERAL RULE.—Section 904(c) (relating to
 14 carryback and carryover of excess tax paid) is amended
 15 by striking “in the first, second, third, fourth, or fifth”
 16 and inserting “in any of the first 20”.

17 (b) EXCESS EXTRACTION TAXES.—Paragraph (1) of
 18 section 907(f) is amended by striking “in the first, second,
 19 third, fourth, or fifth” and inserting “in any of the first
 20 20”.

21 (c) EFFECTIVE DATE.—The amendments made by
 22 this section shall apply to excess foreign taxes which (with-
 23 out regard to the amendments made by this section) may
 24 be carried to any taxable year beginning after December
 25 31, 2004.

1 SEC. 202. LOOK-THRU RULES TO APPLY TO DIVIDENDS

2 FROM NONCONTROLLED SECTION 902 COR-

3 PORATIONS.

4 (a) IN GENERAL.—Section 904(d)(4) (relating to

5 look-thru rules apply to dividends from noncontrolled sec-

6 tion 902 corporations) is amended to read as follows:

7 “(4) LOOK-THRU APPLIES TO DIVIDENDS FROM

8 NONCONTROLLED SECTION 902 CORPORATIONS.—

9 “(A) IN GENERAL.—For purposes of this

10 subsection, any dividend from a noncontrolled

11 section 902 corporation with respect to the tax-

12 payer shall be treated as income described in a

13 subparagraph of paragraph (1) in proportion to

14 the ratio of—

15 “(i) the portion of earnings and prof-

16 its attributable to income described in such

17 subparagraph, to

18 “(ii) the total amount of earnings and

19 profits;

20 “(B) SPECIAL RULES.—For purposes of

21 this paragraph—

22 “(i) EARNINGS AND PROFITS.—

23 “(I) IN GENERAL.—The rules of

24 section 316 shall apply:

25 “(H) REGULATIONS.—The Sec-

26 retary may prescribe regulations re-

1 regarding the treatment of distributions
2 out of earnings and profits for periods
3 before the taxpayer's acquisition of
4 the stock to which the distributions
5 relate:
6 ~~"(ii) INADEQUATE SUBSTAN-~~
7 ~~FIATION.—If the Secretary determines that~~
8 ~~the proper subparagraph of paragraph (1)~~
9 ~~in which a dividend is described has not~~
10 ~~been substantiated, such dividend shall be~~
11 ~~treated as income described in paragraph~~
12 ~~(1)(A):~~
13 ~~"(iii) LOOK-THRU WITH RESPECT TO~~
14 ~~CARRYFORWARDS OF CREDIT.—Rules simi-~~
15 ~~lar to subparagraph (A) also shall apply to~~
16 ~~any carryforward under subsection (c)~~
17 ~~from a taxable year beginning before Janu-~~
18 ~~ary 1, 2003, of tax allocable to a dividend~~
19 ~~from a noncontrolled section 902 corpora-~~
20 ~~tion with respect to the taxpayer. The Sec-~~
21 ~~retary may by regulations provide for the~~
22 ~~allocation of any carryback of tax allocable~~
23 ~~to a dividend from a noncontrolled section~~
24 ~~902 corporation to such a taxable year for~~
25 ~~purposes of allocating such dividend among~~

the separate categories in effect for such

taxable year:

“(iv) COORDINATION WITH HIGH-

TAXED INCOME PROVISIONS.—Rules simi-

lar to the rules of paragraph (3)(F) shall

apply for purposes of this paragraph.”

(b) CONFORMING AMENDMENTS.—

(1) Section 904(d)(2)(E) is amended—

(A) by inserting “or (4)” after “paragraph

(3)” in clause (i); and

(B) by striking clauses (ii) and (iv) and by

redesignating clause (iii) as clause (ii);

(2) Clause (i) of section 864(d)(5)(A) is amend-

ed to read as follows:

“(i) Subclause (i) of section

904(d)(2)(B)(iii).”

(c) EFFECTIVE DATE.—The amendments made by

this section shall apply to taxable years beginning after

December 31, 2002.

SEC. 203. FOREIGN TAX CREDIT UNDER ALTERNATIVE MIN-

IMUM TAX.

(a) IN GENERAL.—

(1) Subsection (a) of section 59 is amended by

striking paragraph (2) and by redesignating para-

1 graphs (3) and (4) as paragraphs (2) and (3), re-
2 spectively.

3 (2) Section 53(d)(1)(B)(i)(II) of such Code is
4 amended by striking “and if section 59(a)(2) did not
5 apply”.

6 (b) **EFFECTIVE DATE.**—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 2004.

9 **SEC. 204. RECHARACTERIZATION OF OVERALL DOMESTIC**
10 **LOSS.**

11 (a) **GENERAL RULE.**—Section 904 is amended by re-
12 designating subsections (g), (h), (i), (j), and (k) as sub-
13 sections (h), (i), (j), (k), and (l) respectively, and by in-
14 serting after subsection (f) the following new subsection:

15 “(g) **RECHARACTERIZATION OF OVERALL DOMESTIC**
16 **LOSS.**—

17 “(1) **GENERAL RULE.**—For purposes of this
18 subpart and section 936, in the case of any taxpayer
19 who sustains an overall domestic loss for any taxable
20 year beginning after December 31, 2006, that por-
21 tion of the taxpayer’s taxable income from sources
22 within the United States for each succeeding taxable
23 year which is equal to the lesser of—

1 “(A) the amount of such loss (to the extent
2 not used under this paragraph in prior taxable
3 years); or

4 “(B) 50 percent of the taxpayer’s taxable
5 income from sources within the United States
6 for such succeeding taxable year;
7 shall be treated as income from sources without the
8 United States (and not as income from sources with-
9 in the United States).

10 “(2) OVERALL DOMESTIC LOSS DEFINED.—For
11 purposes of this subsection—

12 “(A) IN GENERAL.—The term ‘overall do-
13 mestic loss’ means any domestic loss to the ex-
14 tent such loss offsets taxable income from
15 sources without the United States for the tax-
16 able year or for any preceding taxable year by
17 reason of a carryback. For purposes of the pre-
18 ceding sentence, the term ‘domestic loss’ means
19 the amount by which the gross income for the
20 taxable year from sources within the United
21 States is exceeded by the sum of the deductions
22 properly apportioned or allocated thereto (deter-
23 mined without regard to any carryback from a
24 subsequent taxable year).

1 “(B) TAXPAYER MUST HAVE ELECTED
2 FOREIGN TAX CREDIT FOR YEAR OF LOSS.—

3 The term ‘overall domestic loss’ shall not in-
4 clude any loss for any taxable year unless the
5 taxpayer chose the benefits of this subpart for
6 such taxable year.

7 “(3) CHARACTERIZATION OF SUBSEQUENT IN-
8 COME.—

9 “(A) IN GENERAL.—Any income from
10 sources within the United States that is treated
11 as income from sources without the United
12 States under paragraph (1) shall be allocated
13 among and increase the income categories in
14 proportion to the loss from sources within the
15 United States previously allocated to those in-
16 come categories.

17 “(B) INCOME CATEGORY.—For purposes of
18 this paragraph, the term ‘income category’ has
19 the meaning given such term by subsection
20 (f)(5)(E)(i).

21 “(4) COORDINATION WITH SUBSECTION (f).—
22 The Secretary shall prescribe such regulations as
23 may be necessary to coordinate the provisions of this
24 subsection with the provisions of subsection (f).”

25 (b) CONFORMING AMENDMENTS.—

1 (1) Section 535(d)(2) is amended by striking
2 "section 904(g)(6)" and inserting "section
3 904(h)(6)".
4 (2) Subparagraph (A) of section 936(a)(2) is
5 amended by striking "section 904(f)" and inserting
6 "subsections (f) and (g) of section 904".
7 (c) EFFECTIVE DATE.—The amendments made by
8 this section shall apply to losses for taxable years begin-
9 ning after December 31, 2006.
10 SEC. 206. INTEREST EXPENSE ALLOCATION RULES.
11 (a) ELECTION TO ALLOCATE ON WORLDWIDE
12 BASIS.—Section 864 is amended by redesignating sub-
13 section (f) as subsection (g) and by inserting after sub-
14 section (e) the following new subsection:
15 "(f) ELECTION TO ALLOCATE INTEREST, ETC. ON
16 WORLDWIDE BASIS.—For purposes of this subchapter, at
17 the election of the worldwide affiliated group—
18 "(1) ALLOCATION AND APPORTIONMENT OF IN-
19 TEREST EXPENSE.—
20 "(A) IN GENERAL.—The taxable income of
21 each domestic corporation which is a member of
22 a worldwide affiliated group shall be determined
23 by allocating and apportioning interest expense
24 of each member as if all members of such group
25 were a single corporation.

1 “(B) TREATMENT OF WORLDWIDE AFFILI-
2 ATED GROUP.—The taxable income of the do-
3 mestic members of a worldwide affiliated group
4 from sources outside the United States shall be
5 determined by allocating and apportioning the
6 interest expense of such domestic members to
7 such income in an amount equal to the excess
8 (if any) of—
9 “(i) the total interest expense of the
10 worldwide affiliated group multiplied by
11 the ratio which the foreign assets of the
12 worldwide affiliated group bears to all the
13 assets of the worldwide affiliated group;
14 over
15 “(ii) the interest expense of all foreign
16 corporations which are members of the
17 worldwide affiliated group to the extent
18 such interest expense of such foreign cor-
19 porations would have been allocated and
20 apportioned to foreign source income if
21 this subsection were applied to a group
22 consisting of all the foreign corporations in
23 such worldwide affiliated group.
24 “(C) WORLDWIDE AFFILIATED GROUP.—
25 For purposes of this paragraph, the term

1 "worldwide affiliated group" means a group con-
2 sisting of—
3 "(i) the includible members of an af-
4 filiated group (as defined in section
5 1504(a); determined without regard to
6 paragraphs (2) and (4) of section
7 1504(b)); and
8 "(ii) all controlled foreign corpora-
9 tions in which such members in the agree-
10 gate meet the ownership requirements of
11 section 1504(a)(2) either directly or indi-
12 rectly through applying paragraph (2) of
13 section 958(a) or through applying rules
14 similar to the rules of such paragraph to
15 stock owned directly or indirectly by do-
16 mestic partnerships, trusts, or estates.
17 "(2) ALLOCATION AND APPORTIONMENT OF
18 OTHER EXPENSES.—Expenses other than interest
19 which are not directly allocable or apportioned to
20 any specific income producing activity shall be allo-
21 cated and apportioned as if all members of the affli-
22 ated group were a single corporation. For purposes
23 of the preceding sentence, the term "affiliated group"
24 has the meaning given such term by section 1504

(determined without regard to paragraph (4) of section 1504(b)).

"(2) TREATMENT OF TAX-EXEMPT ASSETS; BASIS OF STOCK IN NONAFFILIATED 10 PERCENT OWNED CORPORATIONS.—The rules of paragraphs (3) and (4) of subsection (c) shall apply for purposes of this subsection, except that paragraph (4) shall be applied on worldwide affiliated group basis.

"(4) TREATMENT OF CERTAIN FINANCIAL INSTITUTIONS.—

"(A) IN GENERAL.—For purposes of paragraph (1), any corporation described in subparagraph (B) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying this subsection separately to corporations so described.

"(B) DESCRIPTION.—A corporation is described in this subparagraph if—

"(i) such corporation is a financial institution described in section 581 or 591,

"(ii) the business of such financial institution is predominantly with persons other than related persons (within the meaning of subsection (d)(4)) or their customers; and

1	"(iii) such financial institution is re-
2	quired by State or Federal law to be oper-
3	ated separately from any other entity
4	which is not such an institution:
5	"(C) TREATMENT OF BANK AND FINAN-
6	CIAL HOLDING COMPANIES.—To the extent pro-
7	vided in regulations—
8	"(i) a bank holding company (within
9	the meaning of section 2(a) of the Bank
10	Holding Company Act of 1956),
11	"(ii) a financial holding company
12	(within the meaning of section 2(p) of the
13	Bank Holding Company Act of 1956), and
14	"(iii) any subsidiary of a financial in-
15	stitution described in section 581 or 591,
16	or of any such bank or financial holding
17	company, if such subsidiary is predomi-
18	nantly engaged (directly or indirectly) in
19	the active conduct of a banking, financing,
20	or similar business,
21	shall be treated as a corporation described in
22	subparagraph (B):
23	"(5) ELECTION TO EXPAND FINANCIAL INSTI-
24	TUTION GROUP OF WORLDWIDE GROUP.—

1 “(A) IN GENERAL.—If a worldwide affili-
2 ated group elects the application of this sub-
3 section, all financial corporations which—
4 “(i) are members of such worldwide
5 affiliated group, but
6 “(ii) are not corporations described in
7 paragraph (4)(B);
8 shall be treated as described in paragraph
9 (4)(B) for purposes of applying paragraph
10 (4)(A). This subsection (other than this para-
11 graph) shall apply to any such group in the
12 same manner as this subsection (other than this
13 paragraph) applies to the pre-election worldwide
14 affiliated group of which such group is a part.
15 “(B) FINANCIAL CORPORATION.—For pur-
16 poses of this paragraph, the term ‘financial cor-
17 poration’ means any corporation if at least 80
18 percent of its gross income is income described
19 in section 904(d)(2)(D)(ii) and the regulations
20 thereunder which is derived from transactions
21 with persons who are not related (within the
22 meaning of section 267(b) or 707(b)(1)) to the
23 corporation. For purposes of the preceding sen-
24 tence, there shall be disregarded any item of in-
25 come or gain from a transaction or series of

1 transactions a principal purpose of which is the
2 qualification of any corporation as a financial
3 corporation:
4 "(C) ~~AVOIDANCE RULES.~~—In the case of a
5 corporation which is a member of an electing fi-
6 nancial institution group, to the extent that
7 such corporation—
8 "(i) distributes dividends or makes
9 other distributions with respect to its stock
10 after the date of the enactment of this
11 paragraph to any member of the pre-~~elec-~~
12 tion worldwide affiliated group (other than
13 to a member of the electing financial insti-
14 tution group) in excess of the greater of—
15 "(I) its average annual dividend
16 (expressed as a percentage of current
17 earnings and profits) during the 5-
18 taxable-year period ending with the
19 taxable year preceding the taxable
20 year, or
21 "(II) 25 percent of its average
22 annual earnings and profits for such
23 5-taxable-year period; or
24 "(ii) deals with any person in any
25 manner not clearly reflecting the income of

1 the corporation (as determined under prin-
 2 ciples similar to the principles of section
 3 482),

4 an amount of indebtedness of the electing fi-
 5 nancial institution group equal to the excess
 6 distribution or the understatement or overstate-
 7 ment of income, as the case may be, shall be re-
 8 characterized (for the taxable year and subse-
 9 quent taxable years) for purposes of this para-
 10 graph as indebtedness of the worldwide affli-
 11 ated group (excluding the electing financial in-
 12 stitution group). If a corporation has not been
 13 in existence for 5 taxable years, this subpara-
 14 graph shall be applied with respect to the pe-
 15 riod it was in existence.

16 ~~"(D) ELECTION.~~ An election under this
 17 paragraph with respect to any financial institu-
 18 tion group may be made only by the common
 19 parent of the pre-election worldwide affiliated
 20 group and may be made only for the first tax-
 21 able year beginning after December 31, 2009,
 22 in which such affiliated group includes 1 or
 23 more financial corporations. Such an election,
 24 once made, shall apply to all financial corpora-
 25 tions which are members of the electing finan-

1 cial institution group for such taxable year and
2 all subsequent years unless revoked with the
3 consent of the Secretary.

4 “(E) DEFINITIONS RELATING TO
5 GROUPS.—For purposes of this paragraph—

6 “(i) ~~PRE-ELECTION~~ WORLDWIDE AF-
7 FILIATED GROUP.—The term ‘pre-election
8 worldwide affiliated group’ means, with re-
9 spect to a corporation, the worldwide affli-
10 ated group of which such corporation
11 would (but for an election under this para-
12 graph) be a member for purposes of apply-
13 ing paragraph (1).

14 “(ii) ~~ELECTING~~ FINANCIAL INSTITU-
15 TION GROUP.—The term ‘electing financial
16 institution group’ means the group of cor-
17 porations to which this subsection applies
18 separately by reason of the application of
19 paragraph (4)(A) and which includes fi-
20 nancial corporations by reason of an elec-
21 tion under subparagraph (A).

22 “(F) REGULATIONS.—The Secretary shall
23 prescribe such regulations as may be appro-
24 priate to carry out this subsection, including
25 regulations—

1 "(i) providing for the direct allocation
2 of interest expense in other circumstances
3 where such allocation would be appropriate
4 to carry out the purposes of this sub-
5 section;
6 "(ii) preventing assets or interest ex-
7 pense from being taken into account more
8 than once; and
9 "(iii) dealing with changes in mem-
10 bers of any group (through acquisitions or
11 otherwise) treated under this paragraph as
12 an affiliated group for purposes of this
13 subsection.
14 "(6) ELECTION.—An election to have this sub-
15 section apply with respect to any worldwide affiliated
16 group may be made only by the common parent of
17 the domestic affiliated group referred to in para-
18 graph (1)(C) and may be made only for the first
19 taxable year beginning after December 31, 2009, in
20 which a worldwide affiliated group exists which in-
21 cludes such affiliated group and at least one foreign
22 corporation. Such an election, once made, shall apply
23 to such common parent and all other corporations
24 which are members of such worldwide affiliated

1 group for such taxable year and all subsequent years
 2 unless revoked with the consent of the Secretary.”.

3 (b) **EXPANSION OF REGULATORY AUTHORITY.**—

4 Paragraph (7) of section 864(e) is amended—

5 (1) by inserting before the comma at the end of
 6 subparagraph (B) “and in other circumstances
 7 where such allocation would be appropriate to carry
 8 out the purposes of this subsection”, and

9 (2) by striking “and” at the end of subpara-
 10 graph (E), by redesignating subparagraph (F) as
 11 subparagraph (G), and by inserting after subpara-
 12 graph (E) the following new subparagraph:

13 “(F) preventing assets or interest expense
 14 from being taken into account more than once,
 15 and”.

16 (c) **EFFECTIVE DATE.**—The amendments made by
 17 this section shall apply to taxable years beginning after
 18 December 31, 2009.

19 **SEC. 206. DETERMINATION OF FOREIGN PERSONAL HOLD-**
 20 **ING COMPANY INCOME WITH RESPECT TO**
 21 **TRANSACTIONS IN COMMODITIES.**

22 (a) **IN GENERAL.**—Clauses (i) and (ii) of section
 23 954(e)(1)(C) (relating to commodity transactions) are
 24 amended to read as follows:

1 “(i) arise out of commodity hedging
2 transactions (as defined in paragraph
3 (6)(A));
4 “(ii) are active business gains or
5 losses from the sale of commodities, but
6 only if substantially all of the controlled
7 foreign corporation's commodities are
8 property described in paragraph (1), (2),
9 or (8) of section 1221(a), or;
10 (b) DEFINITION AND SPECIAL RULES.—Subsection
11 (c) of section 954 is amended by adding after paragraph
12 (5) the following new paragraph:
13 “(6) DEFINITION AND SPECIAL RULES RELAT-
14 ING TO COMMODITY TRANSACTIONS.—
15 “(A) COMMODITY HEDGING TRANS-
16 ACTIONS.—For purposes of paragraph
17 (1)(C)(i), the term ‘commodity hedging trans-
18 action’ means any transaction with respect to a
19 commodity if such transaction—
20 “(i) is a hedging transaction as de-
21 fined in section 1221(b)(2), determined—
22 “(I) without regard to subpara-
23 graph (A)(ii) thereof,
24 “(II) by applying subparagraph
25 (A)(i) thereof by substituting ‘ordi-

1 nary property or property described in
2 section 1231(b) for ordinary prop-
3 erty, and
4 "(H) by substituting 'controlled
5 foreign corporation' for 'taxpayer'
6 each place it appears, and
7 "(ii) is clearly identified as such in ac-
8 cordance with section 1221(a)(7);
9 "(B) REGULATIONS.—The Secretary shall
10 prescribe such regulations as are appropriate to
11 carry out the purposes of paragraph (1)(C) in
12 the case of transactions involving related par-
13 ties."
14 (c) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to transactions entered into after
16 December 31, 2004.
17 **Subtitle B—International Tax**
18 **Simplification**
19 SEC. 214. REPEAL OF FOREIGN PERSONAL HOLDING COM-
20 PANY RULES AND FOREIGN INVESTMENT
21 COMPANY RULES.
22 (a) GENERAL RULE.—The following provisions are
23 hereby repealed:
24 (1) Part III of subchapter G of chapter 1 (re-
25 lating to foreign personal holding companies).

1	(2) Section 1246 (relating to gain on foreign in-
2	vestment company stock):
3	(3) Section 1247 (relating to election by foreign
4	investment companies to distribute income cur-
5	rently):
6	(b) EXEMPTION OF FOREIGN CORPORATIONS FROM
7	PERSONAL HOLDING COMPANY RULES.—
8	(1) IN GENERAL.—Subsection (c) of section
9	542 (relating to exceptions) is amended—
10	(A) by striking paragraph (5) and insert-
11	ing the following:
12	“(5) a foreign corporation;”
13	(B) by striking paragraphs (7) and (10)
14	and by redesignating paragraphs (8) and (9) as
15	paragraphs (7) and (8), respectively;
16	(C) by inserting “and” at the end of para-
17	graph (7) (as so redesignated); and
18	(D) by striking “; and” at the end of para-
19	graph (8) (as so redesignated) and inserting a
20	period:
21	(2) TREATMENT OF INCOME FROM PERSONAL
22	SERVICE CONTRACTS.—Paragraph (1) of section
23	954(c) is amended by adding at the end the fol-
24	lowing new subparagraph:
25	“(1) PERSONAL SERVICE CONTRACTS.—

1 “(i) Amounts received under a con-
2 tract under which the corporation is to fur-
3 nish personal services if—

4 “(I) some person other than the
5 corporation has the right to designate
6 (by name or by description) the indi-
7 vidual who is to perform the services,
8 or

9 “(II) the individual who is to per-
10 form the services is designated (by
11 name or by description) in the con-
12 tract, and

13 “(ii) amounts received from the sale
14 or other disposition of such a contract.

15 This subparagraph shall apply with respect to
16 amounts received for services under a particular
17 contract only if at some time during the taxable
18 year 25 percent or more in value of the out-
19 standing stock of the corporation is owned, di-
20 rectly or indirectly, by or for the individual who
21 has performed, is to perform, or may be des-
22 ignated (by name or by description) as the one
23 to perform, such services.”

24 (c) CONFORMING AMENDMENTS.—

25 (1) Section 1(h) is amended—

- 1 (A) in paragraph (10), by inserting "and"
 2 at the end of subparagraph (F), by striking
 3 subparagraph (G), and by redesignating sub-
 4 paragraph (H) as subparagraph (G), and
 5 (B) by striking "a foreign personal holding
 6 company (as defined in section 552), a foreign
 7 investment company (as defined in section
 8 1246(b)), or" in paragraph (11)(C)(iii).
 9 (2) Paragraph (2) of section 171(c) is amend-
 10 ed—
 11 (A) by striking "; or by a foreign personal
 12 holding company, as defined in section 552",
 13 and
 14 (B) by striking "; or foreign personal hold-
 15 ing company".
 16 (3) Paragraph (2) of section 245(a) is amended
 17 by striking "foreign personal holding company or"
 18 (4) Section 312 is amended by striking sub-
 19 section (j).
 20 (5) Subsection (m) of section 312 is amended
 21 by striking "; a foreign investment company (within
 22 the meaning of section 1246(b)), or a foreign per-
 23 sonal holding company (within the meaning of sec-
 24 tion 552)".

- 1 (6) Subsection (c) of section 443 is amended by
- 2 striking paragraph (3) and by redesignating para-
- 3 graphs (4) and (5) as paragraphs (3) and (4), re-
- 4 spectively:
- 5 (7) Subparagraph (B) of section 465(c)(7) is
- 6 amended by adding "or" at the end of clause (i), by
- 7 striking clause (ii), and by redesignating clause (iii)
- 8 as clause (ii):
- 9 (8) Paragraph (1) of section 543(b) is amended
- 10 by inserting "and" at the end of subparagraph (A),
- 11 by striking "; and" at the end of subparagraph (B)
- 12 and inserting a period, and by striking subparagraph
- 13 (C):
- 14 (9) Paragraph (1) of section 562(b) is amended
- 15 by striking "or a foreign personal holding company
- 16 described in section 552":
- 17 (10) Section 563 is amended—
- 18 (A) by striking subsection (c);
- 19 (B) by redesignating subsection (d) as sub-
- 20 section (c), and
- 21 (C) by striking "subsection (a), (b), or (c)"
- 22 in subsection (c) (as so redesignated) and in-
- 23 serting "subsection (a) or (b)":
- 24 (11) Subsection (d) of section 751 is amended
- 25 by adding "and" at the end of paragraph (2), by

1 striking paragraph (3), by redesignating paragraph
2 (4) as paragraph (3), and by striking "paragraph
3 (1), (2), or (3)" in paragraph (3) (as so redesign-
4 ated) and inserting "paragraph (1) or (2)".
5 (12) Paragraph (2) of section 864(d) is amend-
6 ed by striking subparagraph (A) and by redesign-
7 ating subparagraphs (B) and (C) as subparagraphs
8 (A) and (B), respectively.
9 (13)(A) Subparagraph (A) of section 898(b)(1)
10 is amended to read as follows:
11 "(A) which is treated as a controlled for-
12 eign corporation for any purpose under subpart
13 F of part III of this subchapter, and";
14 (B) Subparagraph (B) of section 898(b)(2) is
15 amended by striking "and sections 551(f) and 554,
16 whichever are applicable,"
17 (C) Paragraph (3) of section 898(b) is amended
18 to read as follows:
19 "(3) UNITED STATES SHAREHOLDER.—The
20 term 'United States shareholder' has the meaning
21 given to such term by section 951(b), except that, in
22 the case of a foreign corporation having related per-
23 son insurance income (as defined in section
24 953(c)(2)), the Secretary may treat any person as a
25 United States shareholder for purposes of this sec-

tion if such person is treated as a United States shareholder under section 953(c)(1)."

(D) Subsection (c) of section 898 is amended to read as follows:

"(c) DETERMINATION OF REQUIRED YEAR.—

"(1) IN GENERAL.—The required year is—

"(A) the majority U.S. shareholder year,

or

"(B) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations:

"(2) 1-MONTH DEFERRAL ALLOWED.—A specified foreign corporation may elect, in lieu of the taxable year under paragraph (1)(A), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.

"(3) MAJORITY U.S. SHAREHOLDER YEAR.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'majority U.S. shareholder year' means the taxable year (if any) which, on each testing day, constituted the taxable year of—

"(i) each United States shareholder described in subsection (b)(2)(A), and

1 “(ii) each United States shareholder
2 not described in clause (i) whose stock was
3 treated as owned under subsection
4 (b)(2)(B) by any shareholder described in
5 such clause:
6 “(B) TESTING DAY.—The testing days
7 shall be—
8 “(i) the first day of the corporation’s
9 taxable year (determined without regard to
10 this section); or
11 “(ii) the days during such representa-
12 tive period as the Secretary may pre-
13 scribe.”
14 (14) Clause (ii) of section 904(d)(2)(A) is
15 amended to read as follows:
16 “(ii) CERTAIN AMOUNTS INCLUDED.—
17 Except as provided in clause (iii), the term
18 “passive income” includes, except as pro-
19 vided in subparagraph (E)(iii) or para-
20 graph (3)(I), any amount includible in
21 gross income under section 1203 (relating
22 to certain passive foreign investment com-
23 panies).”
24 (15)(A) Subparagraph (A) of section 904(g)(1),
25 as redesignated by section 204, is amended by add-

1 ing "or" at the end of clause (i); by striking clause
2 (ii); and by redesignating clause (iii) as clause (ii).
3 (B) The paragraph heading of paragraph (2) of
4 section 904(g), as so redesignated, is amended by
5 striking "FOREIGN PERSONAL HOLDING OR".
6 (16) Section 951 is amended by striking sub-
7 sections (c) and (d) and by redesignating subsections
8 (e) and (f) as subsections (c) and (d), respectively.
9 (17) Paragraph (3) of section 989(b) is amend-
10 ed by striking "551(a)".
11 (18) Paragraph (5) of section 1014(b) is
12 amended by inserting "and before January 1,
13 2006," after "August 26, 1937".
14 (19) Subsection (a) of section 1016 is amended
15 by striking paragraph (13).
16 (20)(A) Paragraph (3) of section 1212(a) is
17 amended to read as follows:
18 "(3) SPECIAL RULES ON CARRYBACKS.—A net
19 capital loss of a corporation shall not be carried
20 back under paragraph (1)(A) to a taxable year—
21 "(A) for which it is a regulated investment
22 company (as defined in section 851), or
23 "(B) for which it is a real estate invest-
24 ment trust (as defined in section 856)."

1 (B) The amendment made by subparagraph (A)
2 shall apply to taxable years beginning after Decem-
3 ber 31, 2004.
4 (21) Section 1223 is amended by striking para-
5 graph (10) and by redesignating the following para-
6 graphs accordingly:
7 (22) Subsection (d) of section 1248 is amended
8 by striking paragraph (5) and by redesignating
9 paragraphs (6) and (7) as paragraphs (5) and (6),
10 respectively:
11 (23) Paragraph (2) of section 1260(e) is
12 amended by striking subparagraphs (H) and (I) and
13 by redesignating subparagraph (J) as subparagraph
14 (H).
15 (24)(A) Subparagraph (F) of section
16 1291(b)(3) is amended by striking "551(d), 959(a),"
17 and inserting "959(a)."
18 (B) Subsection (c) of section 1291 is amended
19 by inserting "(as in effect on the day before the date
20 of the enactment of the Jumpstart Our Business
21 Strength (JOBS) Act)" after "section 1246".
22 (25) Paragraph (2) of section 1294(a) is
23 amended to read as follows:
24 "(2) ELECTION NOT PERMITTED WHERE
25 AMOUNTS OTHERWISE INCLUDE UNDER SECTION

1 951.—The taxpayer may not make an election under
 2 paragraph (1) with respect to the undistributed
 3 PFIC earnings tax liability attributable to a quali-
 4 fied electing fund for the taxable year if any amount
 5 is includible in the gross income of the taxpayer
 6 under section 951 with respect to such fund for such
 7 taxable year.”

8 (26) Section 6035 is hereby repealed.

9 (27) Subparagraph (D) of section 6103(c)(1) is
 10 amended by striking clause (iv) and redesignating
 11 clauses (v) and (vi) as clauses (iv) and (v), respec-
 12 tively.

13 (28) Subparagraph (B) of section 6501(c)(1) is
 14 amended to read as follows:

15 “(B) CONSTRUCTIVE DIVIDENDS.—If the
 16 taxpayer omits from gross income an amount
 17 properly includible therein under section
 18 951(a), the tax may be assessed, or a pro-
 19 ceeding in court for the collection of such tax
 20 may be done without assessing, at any time
 21 within 6 years after the return was filed.”

22 (29) Subsection (a) of section 6679 is amend-
 23 ed—

1 (A) by striking “6035, 6046, and 6046A”
 2 in paragraph (1) and inserting “6046 and
 3 6046A”, and

4 (B) by striking paragraph (3).

5 (30) Sections 170(f)(10)(A), 508(d), 4947, and
 6 4948(c)(4) are each amended by striking
 7 “556(b)(2),” each place it appears.

8 (31) The table of parts for subchapter G of
 9 chapter 1 is amended by striking the item relating
 10 to part III.

11 (32) The table of sections for part IV of sub-
 12 chapter P of chapter 1 is amended by striking the
 13 items relating to sections 1246 and 1247.

14 (33) The table of sections for subpart A of part
 15 III of subchapter A of chapter 61 is amended by
 16 striking the item relating to section 6035.

17 (d) EFFECTIVE DATE.—The amendments made by
 18 this section shall apply to taxable years of foreign corpora-
 19 tions beginning after December 31, 2004, and taxable
 20 years of United States shareholders of such corporations
 21 ending with or within such taxable years of such corpora-
 22 tions.

1 SEC. 212. EXPANSION OF DE MINIMIS RULE UNDER SUB-

2 PART F.

3 (a) IN GENERAL.—Clause (ii) of section

4 954(b)(3)(A) (relating to de minimis, etc., rules) is

5 amended by striking “\$1,000,000” and inserting

6 “\$5,000,000”.

7 (b) TECHNICAL AMENDMENTS.—

8 (1) Clause (ii) of section 864(d)(5)(A) is

9 amended by striking “\$1,000,000” and inserting

10 “\$5,000,000”.

11 (2) Clause (i) of section 881(c)(5)(A) is amend-

12 ed by striking “\$1,000,000” and inserting

13 “\$5,000,000”.

14 (c) EFFECTIVE DATE.—The amendments made by

15 this section shall apply to taxable years of foreign corpora-

16 tions beginning after December 31, 2004, and taxable

17 years of United States shareholders of such corporations

18 ending with or within such taxable years of such corpora-

19 tions.

20 SEC. 213. ATTRIBUTION OF STOCK OWNERSHIP THROUGH

21 PARTNERSHIPS TO APPLY IN DETERMINING

22 SECTION 902 AND 960 CREDITS.

23 (a) IN GENERAL.—Subsection (c) of section 902 is

24 amended by redesignating paragraph (7) as paragraph (8)

25 and by inserting after paragraph (6) the following new

26 paragraph:

1 “(7) CONSTRUCTIVE OWNERSHIP THROUGH
2 PARTNERSHIPS.—Stock owned, directly or indirectly,
3 by or for a partnership shall be considered as being
4 owned proportionately by its partners. Stock consid-
5 ered to be owned by a person by reason of the pre-
6 ceding sentence shall, for purposes of applying such
7 sentence, be treated as actually owned by such per-
8 son. The Secretary may prescribe such regulations
9 as may be necessary to carry out the purposes of
10 this paragraph, including rules to account for special
11 partnership allocations of dividends, credits, and
12 other incidents of ownership of stock in determining
13 proportionate ownership.”

14 (b) CLARIFICATION OF COMPARABLE ATTRIBUTION
15 UNDER SECTION 901(b)(5).—Paragraph (5) of section
16 901(b) is amended by striking “any individual” and in-
17 serting “any person”.

18 (c) EFFECTIVE DATE.—The amendments made by
19 this section shall apply to taxes of foreign corporations
20 for taxable years of such corporations beginning after the
21 date of the enactment of this Act.

1 SEC. 214. APPLICATION OF UNIFORM CAPITALIZATION

2 RULES TO FOREIGN PERSONS.

3 (a) IN GENERAL.—Section 263A(c) (relating to ex-
4 ceptions) is amended by adding at the end the following
5 new paragraph:

6 “(7) FOREIGN PERSONS.—Except for purposes
7 of applying sections 871(b)(1) and 882(a)(1), this
8 section shall not apply to any taxpayer who is not
9 a United States person if such taxpayer capitalizes
10 costs of produced property or property acquired for
11 resale by applying the method used to ascertain the
12 income, profit, or loss for purposes of reports or
13 statements to shareholders, partners, other propri-
14 etors, or beneficiaries, or for credit purposes.”

15 (b) EFFECTIVE DATE.—

16 (1) IN GENERAL.—The amendment made by
17 subsection (a) shall apply to taxable years beginning
18 after December 31, 2004.

19 (2) CHANGE IN METHOD OF ACCOUNTING.—In

20 the case of any taxpayer required by the amendment
21 made by this section to change its method of ac-
22 counting for its first taxable year beginning after
23 December 31, 2004—
24 (A) such change shall be treated as initi-
25 ated by the taxpayer;

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account in such first year:

SEC. 215. REPEAL OF WITHHOLDING TAX ON DIVIDENDS FROM CERTAIN FOREIGN CORPORATIONS.

(a) IN GENERAL.—Paragraph (2) of section 871(i) (relating to tax not to apply to certain interest and dividends) is amended by adding at the end the following new subparagraph:

“(D) Dividends paid by a foreign corporation which are treated under section 861(a)(2)(B) as income from sources within the United States.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments made after December 21, 2004.

1 **SEC. 216. REPEAL OF SPECIAL CAPITAL GAINS TAX ON**
 2 **ALIENS PRESENT IN THE UNITED STATES**
 3 **FOR 183 DAYS OR MORE.**

4 (a) **IN GENERAL.**—Subsection (a) of section 871 is
 5 amended by striking paragraph (2) and by redesignating
 6 paragraph (3) as paragraph (2).

7 (b) **EFFECTIVE DATE.**—The amendment made by
 8 this section shall apply to taxable years beginning after
 9 December 31, 2003.

10 **SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE;**
 11 **TABLE OF CONTENTS.**

12 (a) **SHORT TITLE.**—This Act may be cited as the
 13 “Jumpstart Our Business Strength (JOBS) Act”.

14 (b) **AMENDMENT OF 1986 CODE.**—Except as otherwise
 15 expressly provided, whenever in this Act an amendment or
 16 repeal is expressed in terms of an amendment to, or repeal
 17 of, a section or other provision, the reference shall be consid-
 18 ered to be made to a section or other provision of the Inter-
 19 nal Revenue Code of 1986.

20 (c) **TABLE OF CONTENTS.**—

Sec. 1. Short title; amendment of 1986 Code; table of contents.

**TITLE I—PROVISIONS RELATING TO REPEAL OF EXCLUSION FOR
 EXTRATERRITORIAL INCOME**

Sec. 101. Repeal of exclusion for extraterritorial income.

*Sec. 102. Deduction relating to income attributable to United States production
 activities.*

TITLE II—INTERNATIONAL TAX PROVISIONS

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- Sec. 201. 20-year foreign tax credit carryover; 1-year foreign tax credit carryback.*
- Sec. 202. Look-thru rules to apply to dividends from noncontrolled section 902 corporations.*
- Sec. 203. Foreign tax credit under alternative minimum tax.*
- Sec. 204. Recharacterization of overall domestic loss.*
- Sec. 205. Interest expense allocation rules.*
- Sec. 206. Determination of foreign personal holding company income with respect to transactions in commodities.*

Subtitle B—International Tax Simplification

- Sec. 211. Repeal of foreign personal holding company rules and foreign investment company rules.*
- Sec. 212. Expansion of de minimis rule under subpart F.*
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- Sec. 214. Application of uniform capitalization rules to foreign persons.*
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- Sec. 216. Repeal of special capital gains tax on aliens present in the United States for 183 days or more.*

Subtitle C—Additional International Tax Provisions

- Sec. 221. Active leasing income from aircraft and vessels.*
- Sec. 222. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company income rules.*
- Sec. 223. Look-thru treatment for sales of partnership interests.*
- Sec. 224. Election not to use average exchange rate for foreign tax paid other than in functional currency.*
- Sec. 225. Treatment of income tax base differences.*
- Sec. 226. Modification of exceptions under subpart F for active financing.*
- Sec. 227. United States property not to include certain assets of controlled foreign corporation.*
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- Sec. 229. Clarification of treatment of certain transfers of intangible property.*
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- Sec. 231. Toll tax on excess qualified foreign distribution amount.*
- Sec. 232. Exclusion of income derived from certain wagers on horse races and dog races from gross income of nonresident alien individuals.*
- Sec. 233. Limitation of withholding tax for Puerto Rico corporations.*
- Sec. 234. Report on WTO dispute settlement panels and the appellate body.*
- Sec. 235. Study of impact of international tax laws on taxpayers other than large corporations.*
- Sec. 236. Consultative role for Senate Committee on Finance in connection with the review of proposed tax treaties.*

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- Sec. 301. Expansion of qualified small-issue bond program.*
- Sec. 302. Expensing of broadband Internet access expenditures.*
- Sec. 303. Exemption of natural aging process in determination of production period for distilled spirits under section 263A.*
- Sec. 304. Modification of active business definition under section 355.*
- Sec. 305. Exclusion of certain indebtedness of small business investment companies from acquisition indebtedness.*
- Sec. 306. Modified taxation of imported archery products.*
- Sec. 307. Modification to cooperative marketing rules to include value added processing involving animals.*
- Sec. 308. Extension of declaratory judgment procedures to farmers' cooperative organizations.*
- Sec. 309. Temporary suspension of personal holding company tax.*
- Sec. 310. Increase in section 179 expensing.*
- Sec. 311. Three-year carryback of net operating losses.*

Subtitle B—Manufacturing Relating to Films

- Sec. 321. Special rules for certain film and television productions.*
- Sec. 322. Modification of application of income forecast method of depreciation.*

Subtitle C—Manufacturing Relating to Timber

- Sec. 331. Expensing of certain reforestation expenditures.*
- Sec. 332. Election to treat cutting of timber as a sale or exchange.*
- Sec. 333. Capital gain treatment under section 631(b) to apply to outright sales by landowners.*
- Sec. 334. Modification of safe harbor rules for timber REITS.*

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- Sec. 401. Clarification of economic substance doctrine.*
- Sec. 402. Penalty for failing to disclose reportable transaction.*
- Sec. 403. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.*
- Sec. 404. Penalty for understatements attributable to transactions lacking economic substance, etc.*
- Sec. 405. Modifications of substantial understatement penalty for nonreportable transactions.*
- Sec. 406. Tax shelter exception to confidentiality privileges relating to taxpayer communications.*
- Sec. 407. Disclosure of reportable transactions.*
- Sec. 408. Modifications to penalty for failure to register tax shelters.*
- Sec. 409. Modification of penalty for failure to maintain lists of investors.*
- Sec. 410. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.*
- Sec. 411. Understatement of taxpayer's liability by income tax return preparer.*
- Sec. 412. Penalty on failure to report interests in foreign financial accounts.*
- Sec. 413. Frivolous tax submissions.*
- Sec. 414. Regulation of individuals practicing before the Department of Treasury.*
- Sec. 415. Penalty on promoters of tax shelters.*

Sec. 416. Statute of limitations for taxable years for which required listed transactions not reported.

Sec. 417. Denial of deduction for interest on underpayments attributable to non-disclosed reportable and noneconomic substance transactions.

Sec. 418. Authorization of appropriations for tax law enforcement.

Subtitle B—Other Corporate Governance Provisions

Sec. 421. Affirmation of consolidated return regulation authority.

Sec. 422. Signing of corporate tax returns by chief executive officer.

Sec. 423. Denial of deduction for certain fines, penalties, and other amounts.

Sec. 424. Disallowance of deduction for punitive damages.

Sec. 425. Increase in criminal monetary penalty limitation for the underpayment or overpayment of tax due to fraud.

Subtitle C—Enron-Related Tax Shelter Provisions

Sec. 431. Limitation on transfer or importation of built-in losses.

Sec. 432. No reduction of basis under section 734 in stock held by partnership in corporate partner.

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Sec. 475. Consistent amortization of periods for intangibles.

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Sec. 481. Clarification of rules for payment of estimated tax for certain deemed asset sales.

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Sec. 491. Addition of vaccines against hepatitis A to list of taxable vaccines.

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Sec. 493. Clarification of exemption from tax for small property and casualty insurance companies.

Sec. 494. Definition of insurance company for section 831.

Sec. 495. Limitations on deduction for charitable contributions of patents and similar property.

Sec. 496. Repeal of 10-percent rehabilitation tax credit.

Sec. 497. Increase in age of minor children whose unearned income is taxed as if parent's income.

1 **TITLE I—PROVISIONS RELATING**
 2 **TO REPEAL OF EXCLUSION**
 3 **FOR EXTRATERRITORIAL IN-**
 4 **COME**

5 **SEC. 101. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL**
 6 **INCOME.**

7 (a) *IN GENERAL.*—Section 114 is hereby repealed.

8 (b) *CONFORMING AMENDMENTS.*—

9 (1)(A) *Subpart E of part III of subchapter N of*
 10 *chapter 1 (relating to qualifying foreign trade in-*
 11 *come) is hereby repealed.*

12 (B) *The table of subparts for such part III is*
 13 *amended by striking the item relating to subpart E.*

14 (2) *The table of sections for part III of sub-*
 15 *chapter B of chapter 1 is amended by striking the*
 16 *item relating to section 114.*

17 (3) *The second sentence of section 56(g)(4)(B)(i)*
 18 *is amended by striking “or under section 114”.*

19 (4) *Section 275(a) is amended—*

20 (A) *by inserting “or” at the end of para-*
 21 *graph (4)(A), by striking “or” at the end of*
 22 *paragraph (4)(B) and inserting a period, and by*
 23 *striking subparagraph (C), and*

24 (B) *by striking the last sentence.*

1 (5) Paragraph (3) of section 864(e) is amend-
2 ed—

3 (A) by striking:

4 “(3) TAX-EXEMPT ASSETS NOT TAKEN INTO AC-
5 COUNT.—

6 “(A) IN GENERAL.—For purposes of”; and
7 inserting:

8 “(3) TAX-EXEMPT ASSETS NOT TAKEN INTO AC-
9 COUNT.—For purposes of”, and

10 (B) by striking subparagraph (B).

11 (6) Section 903 is amended by striking “114,
12 164(a),” and inserting “164(a)”.

13 (7) Section 999(c)(1) is amended by striking
14 “941(a)(5),”.

15 (c) EFFECTIVE DATE.—

16 (1) IN GENERAL.—The amendments made by
17 this section shall apply to transactions occurring after
18 the date of the enactment of this Act.

19 (2) BINDING CONTRACTS.—The amendments
20 made by this section shall not apply to any trans-
21 action in the ordinary course of a trade or business
22 which occurs pursuant to a binding contract—

23 (A) which is between the taxpayer and a
24 person who is not a related person (as defined in
25 section 943(b)(3) of such Code, as in effect on the

1 *day before the date of the enactment of this Act),*
 2 *and*

3 *(B) which is in effect on September 17,*
 4 *2003, and at all times thereafter.*

5 *(d) REVOCATION OF SECTION 943(e) ELECTIONS.—*

6 *(1) IN GENERAL.—In the case of a corporation*
 7 *that elected to be treated as a domestic corporation*
 8 *under section 943(e) of the Internal Revenue Code of*
 9 *1986 (as in effect on the day before the date of the en-*
 10 *actment of this Act)—*

11 *(A) the corporation may, during the 1-year*
 12 *period beginning on the date of the enactment of*
 13 *this Act, revoke such election, effective as of such*
 14 *date of enactment, and*

15 *(B) if the corporation does revoke such elec-*
 16 *tion—*

17 *(i) such corporation shall be treated as*
 18 *a domestic corporation transferring (as of*
 19 *such date of enactment) all of its property*
 20 *to a foreign corporation in connection with*
 21 *an exchange described in section 354 of such*
 22 *Code, and*

23 *(ii) no gain or loss shall be recognized*
 24 *on such transfer.*

1 (2) *EXCEPTION.*—Subparagraph (B)(ii) of para-
 2 graph (1) shall not apply to gain on any asset held
 3 by the revoking corporation if—

4 (A) the basis of such asset is determined in
 5 whole or in part by reference to the basis of such
 6 asset in the hands of the person from whom the
 7 revoking corporation acquired such asset,

8 (B) the asset was acquired by transfer (not
 9 as a result of the election under section 943(e) of
 10 such Code) occurring on or after the 1st day on
 11 which its election under section 943(e) of such
 12 Code was effective, and

13 (C) a principal purpose of the acquisition
 14 was the reduction or avoidance of tax (other
 15 than a reduction in tax under section 114 of
 16 such Code, as in effect on the day before the date
 17 of the enactment of this Act).

18 (e) *GENERAL TRANSITION.*—

19 (1) *IN GENERAL.*—In the case of a taxable year
 20 ending after the date of the enactment of this Act and
 21 beginning before January 1, 2007, for purposes of
 22 chapter 1 of such Code, a current FSC/ETI bene-
 23 ficiary shall be allowed a deduction equal to the tran-
 24 sition amount determined under this subsection with
 25 respect to such beneficiary for such year.

1 (2) *CURRENT FSC/ETI BENEFICIARY.*—The term
 2 “current FSC/ETI beneficiary” means any corpora-
 3 tion which entered into one or more transactions dur-
 4 ing its taxable year beginning in calendar year 2002
 5 with respect to which FSC/ETI benefits were allow-
 6 able.

7 (3) *TRANSITION AMOUNT.*—For purposes of this
 8 subsection—

9 (A) *IN GENERAL.*—The transition amount
 10 applicable to any current FSC/ETI beneficiary
 11 for any taxable year is the phaseout percentage
 12 of the base period amount.

13 (B) *PHASEOUT PERCENTAGE.*—

14 (i) *IN GENERAL.*—In the case of a tax-
 15 payer using the calendar year as its taxable
 16 year, the phaseout percentage shall be deter-
 17 mined under the following table:

Years:	The phaseout percentage is:
2004	80
2005	80
2006	60.

18 (ii) *SPECIAL RULE FOR 2003.*—The
 19 phaseout percentage for 2003 shall be the
 20 amount that bears the same ratio to 100
 21 percent as the number of days after the date
 22 of the enactment of this Act bears to 365.

1 (iii) *SPECIAL RULE FOR FISCAL YEAR*

2 *TAXPAYERS.—In the case of a taxpayer not*
 3 *using the calendar year as its taxable year,*
 4 *the phaseout percentage is the weighted av-*
 5 *erage of the phaseout percentages deter-*
 6 *mined under the preceding provisions of*
 7 *this paragraph with respect to calendar*
 8 *years any portion of which is included in*
 9 *the taxpayer's taxable year. The weighted*
 10 *average shall be determined on the basis of*
 11 *the respective portions of the taxable year in*
 12 *each calendar year.*

13 (C) *SHORT TAXABLE YEAR.—The Secretary*
 14 *shall prescribe guidance for the computation of*
 15 *the transition amount in the case of a short tax-*
 16 *able year.*

17 (4) *BASE PERIOD AMOUNT.—For purposes of this*
 18 *subsection, the base period amount is the FSC/ETI*
 19 *benefit for the taxpayer's taxable year beginning in*
 20 *calendar year 2002.*

21 (5) *FSC/ETI BENEFIT.—For purposes of this*
 22 *subsection, the term "FSC/ETI benefit" means—*

23 (A) *amounts excludable from gross income*
 24 *under section 114 of such Code, and*

1 (B) the exempt foreign trade income of re-
 2 lated foreign sales corporations from property
 3 acquired from the taxpayer (determined without
 4 regard to section 923(a)(5) of such Code (relating
 5 to special rule for military property), as in effect
 6 on the day before the date of the enactment of the
 7 FSC Repeal and Extraterritorial Income Exclu-
 8 sion Act of 2000).

9 In determining the FSC/ETI benefit there shall be ex-
 10 cluded any amount attributable to a transaction with
 11 respect to which the taxpayer is the lessor unless the
 12 leased property was manufactured or produced in
 13 whole or in significant part by the taxpayer.

14 (6) SPECIAL RULE FOR AGRICULTURAL AND
 15 HORTICULTURAL COOPERATIVES.—Determinations
 16 under this subsection with respect to an organization
 17 described in section 943(g)(1) of such Code, as in ef-
 18 fect on the day before the date of the enactment of this
 19 Act, shall be made at the cooperative level and the
 20 purposes of this subsection shall be carried out in a
 21 manner similar to section 199(h)(2) of such Code, as
 22 added by this Act. Such determinations shall be in
 23 accordance with such requirements and procedures as
 24 the Secretary may prescribe.

1 (7) *CERTAIN RULES TO APPLY.*—Rules similar to
 2 the rules of section 41(f) of such Code shall apply for
 3 purposes of this subsection.

4 (8) *COORDINATION WITH BINDING CONTRACT*
 5 *RULE.*—The deduction determined under paragraph
 6 (1) for any taxable year shall be reduced by the
 7 phaseout percentage of any FSC/ETI benefit realized
 8 for the taxable year by reason of subsection (c)(2) or
 9 section 5(c)(1)(B) of the FSC Repeal and
 10 Extraterritorial Income Exclusion Act of 2000, except
 11 that for purposes of this paragraph the phaseout per-
 12 centage for 2003 shall be treated as being equal to 100
 13 percent.

14 (9) *SPECIAL RULE FOR TAXABLE YEAR WHICH*
 15 *INCLUDES DATE OF ENACTMENT.*—In the case of a
 16 taxable year which includes the date of the enactment
 17 of this Act, the deduction allowed under this sub-
 18 section to any current FSC/ETI beneficiary shall in
 19 no event exceed—

20 (A) 100 percent of such beneficiary's base
 21 period amount for calendar year 2003, reduced
 22 by

23 (B) the FSC/ETI benefit of such beneficiary
 24 with respect to transactions occurring during the

1 portion of the taxable year ending on the date of
2 the enactment of this Act.

3 **SEC. 102. DEDUCTION RELATING TO INCOME ATTRIB-**
4 **UTABLE TO UNITED STATES PRODUCTION AC-**
5 **TIVITIES.**

6 (a) *IN GENERAL.*—Part VI of subchapter B of chapter
7 1 (relating to itemized deductions for individuals and cor-
8 porations) is amended by adding at the end the following
9 new section:

10 **“SEC. 199. INCOME ATTRIBUTABLE TO DOMESTIC PRODUC-**
11 **TION ACTIVITIES.**

12 “(a) *ALLOWANCE OF DEDUCTION.*—

13 “(1) *IN GENERAL.*—There shall be allowed as a
14 deduction an amount equal to 9 percent of the quali-
15 fied production activities income of the taxpayer for
16 the taxable year.

17 “(2) *PHASEIN.*—In the case of taxable years be-
18 ginning in 2003, 2004, 2005, 2006, 2007, or 2008,
19 paragraph (1) shall be applied by substituting for the
20 percentage contained therein the transition percentage
21 determined under the following table:

“Taxable years beginning in:	The transition percentage is:
2003 or 2004	1
2005	2
2006	3
2007 or 2008	6.

22 “(b) *DEDUCTION LIMITED TO WAGES PAID.*—

1 “(1) *IN GENERAL.*—*The amount of the deduction*
 2 *allowable under subsection (a) for any taxable year*
 3 *shall not exceed 50 percent of the W-2 wages of the*
 4 *employer for the taxable year.*

5 “(2) *W-2 WAGES.*—*For purposes of paragraph*
 6 *(1), the term ‘W-2 wages’ means the sum of the aggre-*
 7 *gate amounts the taxpayer is required to include on*
 8 *statements under paragraphs (3) and (8) of section*
 9 *6051(a) with respect to employment of employees of*
 10 *the taxpayer during the taxpayer’s taxable year.*

11 “(3) *SPECIAL RULES.*—

12 “(A) *PASS-THRU ENTITIES.*—*In the case of*
 13 *an S corporation, partnership, estate or trust, or*
 14 *other pass-thru entity, the limitation under this*
 15 *subsection shall apply at the entity level.*

16 “(B) *ACQUISITIONS AND DISPOSITIONS.*—
 17 *The Secretary shall provide for the application*
 18 *of this subsection in cases where the taxpayer ac-*
 19 *quires, or disposes of, the major portion of a*
 20 *trade or business or the major portion of a sepa-*
 21 *rate unit of a trade or business during the tax-*
 22 *able year.*

23 “(C) *QUALIFIED PRODUCTION ACTIVITIES INCOME.*—
 24 *For purposes of this section—*

1 “(1) *IN GENERAL.*—The term ‘qualified produc-
 2 tion activities income’ means an amount equal to the
 3 portion of the modified taxable income of the taxpayer
 4 which is attributable to domestic production activi-
 5 ties.

6 “(2) *REDUCTION FOR TAXABLE YEARS BEGIN-*
 7 *NING BEFORE 2013.*—The amount otherwise deter-
 8 mined under paragraph (1) (the ‘unreduced amount’)
 9 shall not exceed—

10 “(A) in the case of taxable years beginning
 11 before 2010, the product of the unreduced
 12 amount and the domestic/worldwide fraction,
 13 and

14 “(B) in the case of taxable years beginning
 15 in 2010, 2011, or 2012, an amount equal to the
 16 sum of—

17 “(i) the product of the unreduced
 18 amount and the domestic/worldwide frac-
 19 tion, plus

20 “(ii) the applicable percentage of an
 21 amount equal to the unreduced amount
 22 minus the amount determined under clause
 23 (i).

1 For purposes of subparagraph (B)(ii), the applicable
 2 percentage is 25 percent for 2010, 50 percent for
 3 2011, and 75 percent for 2012.

4 “(d) *DETERMINATION OF INCOME ATTRIBUTABLE TO*
 5 *DOMESTIC PRODUCTION ACTIVITIES.*—For purposes of this
 6 section—

7 “(1) *IN GENERAL.*—The portion of the modified
 8 taxable income which is attributable to domestic pro-
 9 duction activities is so much of the modified taxable
 10 income for the taxable year as does not exceed—

11 “(A) the taxpayer’s domestic production
 12 gross receipts for such taxable year, reduced by

13 “(B) the sum of—

14 “(i) the costs of goods sold that are al-
 15 locable to such receipts,

16 “(ii) other deductions, expenses, or
 17 losses directly allocable to such receipts, and

18 “(iii) a proper share of other deduc-
 19 tions, expenses, and losses that are not di-
 20 rectly allocable to such receipts or another
 21 class of income.

22 “(2) *ALLOCATION METHOD.*—The Secretary shall
 23 prescribe rules for the proper allocation of items of in-
 24 come, deduction, expense, and loss for purposes of de-

1 *termining income attributable to domestic production*
 2 *activities.*

3 *“(3) SPECIAL RULES FOR DETERMINING*
 4 *COSTS.—*

5 *“(A) IN GENERAL.—For purposes of deter-*
 6 *mining costs under clause (i) of paragraph*
 7 *(1)(B), any item or service brought into the*
 8 *United States shall be treated as acquired by*
 9 *purchase, and its cost shall be treated as not less*
 10 *than its fair market value immediately after it*
 11 *entered the United States. A similar rule shall*
 12 *apply in determining the adjusted basis of leased*
 13 *or rented property where the lease or rental gives*
 14 *rise to domestic production gross receipts.*

15 *“(B) EXPORTS FOR FURTHER MANUFAC-*
 16 *TURE.—In the case of any property described in*
 17 *subparagraph (A) that had been exported by the*
 18 *taxpayer for further manufacture, the increase in*
 19 *cost or adjusted basis under subparagraph (A)*
 20 *shall not exceed the difference between the value*
 21 *of the property when exported and the value of*
 22 *the property when brought back into the United*
 23 *States after the further manufacture.*

24 *“(4) MODIFIED TAXABLE INCOME.—The term*
 25 *‘modified taxable income’ means taxable income com-*

1 *puted without regard to the deduction allowable under*
 2 *this section.*

3 *“(e) DOMESTIC PRODUCTION GROSS RECEIPTS.—For*
 4 *purposes of this section—*

5 *“(1) IN GENERAL.—The term ‘domestic produc-*
 6 *tion gross receipts’ means the gross receipts of the tax-*
 7 *payer which are derived from—*

8 *“(A) any sale, exchange, or other disposi-*
 9 *tion of, or*

10 *“(B) any lease, rental, or license of,*
 11 *qualifying production property which was manufac-*
 12 *tured, produced, grown, or extracted in whole or in*
 13 *significant part by the taxpayer within the United*
 14 *States.*

15 *“(2) SPECIAL RULES FOR CERTAIN PROPERTY.—*
 16 *In the case of any qualifying production property de-*
 17 *scribed in subsection (f)(1)(C)—*

18 *“(A) such property shall be treated for pur-*
 19 *poses of paragraph (1) as produced in signifi-*
 20 *cant part by the taxpayer within the United*
 21 *States if more than 50 percent of the aggregate*
 22 *development and production costs are incurred*
 23 *by the taxpayer within the United States, and*

24 *“(B) if a taxpayer acquires such property*
 25 *before such property begins to generate substan-*

1 *tial gross receipts, any development or produc-*
 2 *tion costs incurred before the acquisition shall be*
 3 *treated as incurred by the taxpayer for purposes*
 4 *of subparagraph (A) and paragraph (1).*

5 *“(f) QUALIFYING PRODUCTION PROPERTY.—For pur-*
 6 *poses of this section—*

7 *“(1) IN GENERAL.—Except as otherwise provided*
 8 *in this paragraph, the term ‘qualifying production*
 9 *property’ means—*

10 *“(A) any tangible personal property,*

11 *“(B) any computer software, and*

12 *“(C) any property described in section*
 13 *168(f) (3) or (4), including any underlying*
 14 *copyright or trademark.*

15 *“(2) EXCLUSIONS FROM QUALIFYING PRODUC-*
 16 *TION PROPERTY.—The term ‘qualifying production*
 17 *property’ shall not include—*

18 *“(A) consumable property that is sold,*
 19 *leased, or licensed by the taxpayer as an integral*
 20 *part of the provision of services,*

21 *“(B) oil or gas,*

22 *“(C) electricity,*

23 *“(D) water supplied by pipeline to the con-*
 24 *sumer,*

25 *“(E) utility services, or*

1 “(F) any film, tape, recording, book, maga-
 2 zine, newspaper, or similar property the market
 3 for which is primarily topical or otherwise essen-
 4 tially transitory in nature.

5 “(g) DOMESTIC/WORLDWIDE FRACTION.—For pur-
 6 poses of this section—

7 “(1) IN GENERAL.—The term ‘domestic/world-
 8 wide fraction’ means a fraction (not greater than
 9 1)—

10 “(A) the numerator of which is the value of
 11 the domestic production of the taxpayer, and

12 “(B) the denominator of which is the value
 13 of the worldwide production of the taxpayer.

14 “(2) VALUE OF DOMESTIC PRODUCTION.—The
 15 value of domestic production is the excess (if any)
 16 of—

17 “(A) the domestic production gross receipts,
 18 over

19 “(B) the cost of purchased inputs allocable
 20 to such receipts that are deductible under this
 21 chapter for the taxable year.

22 “(3) PURCHASED INPUTS.—

23 “(A) IN GENERAL.—Purchased inputs are
 24 any of the following items acquired by purchase:

1 “(i) *Services (other than services of em-*
 2 *ployees) used in manufacture, production,*
 3 *growth, or extraction activities.*

4 “(ii) *Items consumed in connection*
 5 *with such activities.*

6 “(iii) *Items incorporated as part of the*
 7 *property being manufactured, produced,*
 8 *grown, or extracted.*

9 “(B) *SPECIAL RULE.—Rules similar to the*
 10 *rules of subsection (d)(3) shall apply for pur-*
 11 *poses of this subsection.*

12 “(4) *VALUE OF WORLDWIDE PRODUCTION.—*

13 “(A) *IN GENERAL.—The value of worldwide*
 14 *production shall be determined under the prin-*
 15 *ciples of paragraph (2), except that—*

16 “(i) *worldwide production gross re-*
 17 *ceipts shall be taken into account, and*

18 “(ii) *paragraph (3)(B) shall not apply.*

19 “(B) *WORLDWIDE PRODUCTION GROSS RE-*
 20 *CEIPTS.—The worldwide production gross re-*
 21 *ceipts is the amount that would be determined*
 22 *under subsection (e) if such subsection were ap-*
 23 *plied without any reference to the United States.*

24 “(h) *DEFINITIONS AND SPECIAL RULES.—*

1 “(1) *APPLICATION OF SECTION TO PASS-THRU*
 2 *ENTITIES.—In the case of an S corporation, partner-*
 3 *ship, estate or trust, or other pass-thru entity—*

4 “(A) *subject to the provisions of paragraph*
 5 *(2) and subsection (b)(3)(A), this section shall be*
 6 *applied at the shareholder, partner, or similar*
 7 *level, and*

8 “(B) *the Secretary shall prescribe rules for*
 9 *the application of this section, including rules*
 10 *relating to—*

11 “(i) *restrictions on the allocation of the*
 12 *deduction to taxpayers at the partner or*
 13 *similar level, and*

14 “(ii) *additional reporting require-*
 15 *ments.*

16 “(2) *EXCLUSION FOR PATRONS OF AGRICUL-*
 17 *TURAL AND HORTICULTURAL COOPERATIVES.—*

18 “(A) *IN GENERAL.—If any amount de-*
 19 *scribed in paragraph (1) or (3) of section 1385*
 20 *(a)—*

21 “(i) *is received by a person from an*
 22 *organization to which part I of subchapter*
 23 *T applies which is engaged in the mar-*
 24 *keting of agricultural or horticultural prod-*
 25 *ucts, and*

1 “(ii) is allocable to the portion of the
 2 qualified production activities income of the
 3 organization which is deductible under sub-
 4 section (a) and designated as such by the
 5 organization in a written notice mailed to
 6 its patrons during the payment period de-
 7 scribed in section 1382(d),

8 then such person shall be allowed an exclusion
 9 from gross income with respect to such amount.

10 The taxable income of the organization shall not
 11 be reduced under section 1382 by the portion of
 12 any such amount with respect to which an exclu-
 13 sion is allowable to a person by reason of this
 14 paragraph.

15 “(B) SPECIAL RULES.—For purposes of ap-
 16 plying subparagraph (A), in determining the
 17 qualified production activities income of the or-
 18 ganization under this section—

19 “(i) there shall not be taken into ac-
 20 count in computing the organization’s
 21 modified taxable income any deduction al-
 22 lowable under subsection (b) or (c) of sec-
 23 tion 1382 (relating to patronage dividends,
 24 per-unit retain allocations, and nonpatron-
 25 age distributions), and

1 “(ii) the organization shall be treated
2 as having manufactured, produced, grown,
3 or extracted in whole or significant part
4 any qualifying production property mar-
5 keted by the organization which its patrons
6 have so manufactured, produced, grown, or
7 extracted.

8 “(3) SPECIAL RULE FOR AFFILIATED GROUPS.—

9 “(A) IN GENERAL.—All members of an ex-
10 panded affiliated group shall be treated as a sin-
11 gle corporation for purposes of this section.

12 “(B) EXPANDED AFFILIATED GROUP.—The
13 term ‘expanded affiliated group’ means an affili-
14 ated group as defined in section 1504(a), deter-
15 mined—

16 “(i) by substituting ‘50 percent’ for ‘80
17 percent’ each place it appears, and

18 “(ii) without regard to paragraphs (2)
19 and (4) of section 1504(b).

20 For purposes of determining the domestic/world-
21 wide fraction under subsection (g), clause (ii)
22 shall be applied by also disregarding paragraphs
23 (3) and (8) of section 1504(b).

24 “(4) COORDINATION WITH MINIMUM TAX.—The
25 deduction under this section shall be allowed for pur-

1 *poses of the tax imposed by section 55; except that for*
 2 *purposes of section 55, alternative minimum taxable*
 3 *income shall be taken into account in determining the*
 4 *deduction under this section.*

5 *“(5) ORDERING RULE.—The amount of any*
 6 *other deduction allowable under this chapter shall be*
 7 *determined as if this section had not been enacted.*

8 *“(6) TRADE OR BUSINESS REQUIREMENT.—This*
 9 *section shall be applied by only taking into account*
 10 *items which are attributable to the actual conduct of*
 11 *a trade or business.*

12 *“(7) POSSESSIONS, ETC.—*

13 *“(A) IN GENERAL.—For purposes of sub-*
 14 *sections (d) and (e), the term ‘United States’ in-*
 15 *cludes the Commonwealth of Puerto Rico, Guam,*
 16 *American Samoa, the Commonwealth of the*
 17 *Northern Mariana Islands, and the Virgin Is-*
 18 *lands of the United States.*

19 *“(B) SPECIAL RULES FOR APPLYING WAGE*
 20 *LIMITATION.—For purposes of applying the limi-*
 21 *tation under subsection (b) for any taxable*
 22 *year—*

23 *“(i) the determination of W-2 wages of*
 24 *a taxpayer shall be made without regard to*
 25 *any exclusion under section 3401(a)(8) for*

1 remuneration paid for services performed in
 2 a jurisdiction described in subparagraph
 3 (A), and

4 “(ii) in determining the amount of
 5 any credit allowable under section 30A or
 6 936 for the taxable year, there shall not be
 7 taken into account any wages which are
 8 taken into account in applying such limita-
 9 tion.

10 “(8) COORDINATION WITH TRANSITION RULES.—

11 For purposes of this section—

12 “(A) domestic production gross receipts
 13 shall not include gross receipts from any trans-
 14 action if the binding contract transition relief of
 15 section 101(c)(2) of the Jumpstart Our Business
 16 Strength (JOBS) Act applies to such trans-
 17 action, and

18 “(B) any deduction allowed under section
 19 101(e) of such Act shall be disregarded in deter-
 20 mining the portion of the taxable income which
 21 is attributable to domestic production gross re-
 22 cepts.”.

23 (b) MINIMUM TAX.—Section 56(g)(4)(C) (relating to
 24 disallowance of items not deductible in computing earnings

1 and profits) is amended by adding at the end the following
 2 new clause:

3 “(v) DEDUCTION FOR DOMESTIC PRO-
 4 DUCTION.—Clause (i) shall not apply to
 5 any amount allowable as a deduction under
 6 section 199.”.

7 (c) CLERICAL AMENDMENT.—The table of sections for
 8 part VI of subchapter B of chapter 1 is amended by adding
 9 at the end the following new item:

 “Sec. 199. Income attributable to domestic production activities.”.

10 (d) EFFECTIVE DATE.—

11 (1) IN GENERAL.—The amendments made by
 12 this section shall apply to taxable years ending after
 13 the date of the enactment of this Act.

14 (2) APPLICATION OF SECTION 15.—Section 15 of
 15 the Internal Revenue Code of 1986 shall apply to the
 16 amendments made by this section as if they were
 17 changes in a rate of tax.

18 **TITLE II—INTERNATIONAL TAX** 19 **PROVISIONS**

20 **Subtitle A—International Tax** 21 **Reform**

22 **SEC. 201. 20-YEAR FOREIGN TAX CREDIT CARRYOVER; 1-** 23 **YEAR FOREIGN TAX CREDIT CARRYBACK.**

24 (a) GENERAL RULE.—Section 904(c) (relating to
 25 carryback and carryover of excess tax paid) is amended—

1 (1) by striking “in the second preceding taxable
2 year,” and

3 (2) by striking “, and in the first, second, third,
4 fourth, or fifth” and inserting “and in any of the first
5 20”.

6 (b) *EXCESS EXTRACTION TAXES*.—Paragraph (1) of
7 section 907(f) is amended—

8 (1) by striking “in the second preceding taxable
9 year,”

10 (2) by striking “, and in the first, second, third,
11 fourth, or fifth” and inserting “and in any of the first
12 20”, and

13 (3) by striking the last sentence.

14 (c) *EFFECTIVE DATE*.—

15 (1) *CARRYBACK*.—The amendments made by sub-
16 sections (a)(1) and (b)(1) shall apply to excess foreign
17 taxes arising in taxable years beginning after the date
18 of the enactment of this Act.

19 (2) *CARRYOVER*.—The amendments made by sub-
20 sections (a)(2) and (b)(2) shall apply to excess foreign
21 taxes which (without regard to the amendments made
22 by this section) may be carried to any taxable year
23 ending after the date of the enactment of this Act.

1 **SEC. 202. LOOK-THRU RULES TO APPLY TO DIVIDENDS**
 2 **FROM NONCONTROLLED SECTION 902 COR-**
 3 **PORATIONS.**

4 (a) *IN GENERAL.*—Section 904(d)(4) (relating to look-
 5 thru rules apply to dividends from noncontrolled section
 6 902 corporations) is amended to read as follows:

7 “(4) **LOOK-THRU APPLIES TO DIVIDENDS FROM**
 8 **NONCONTROLLED SECTION 902 CORPORATIONS.**—

9 “(A) *IN GENERAL.*—For purposes of this
 10 subsection, any dividend from a noncontrolled
 11 section 902 corporation with respect to the tax-
 12 payer shall be treated as income described in a
 13 subparagraph of paragraph (1) in proportion to
 14 the ratio of—

15 “(i) the portion of earnings and profits
 16 attributable to income described in such
 17 subparagraph, to

18 “(ii) the total amount of earnings and
 19 profits.

20 “(B) **EARNINGS AND PROFITS OF CON-**
 21 **TROLLED FOREIGN CORPORATIONS.**—In the case
 22 of any distribution from a controlled foreign cor-
 23 poration to a United States shareholder, rules
 24 similar to the rules of subparagraph (A) shall
 25 apply in determining the extent to which earn-
 26 ings and profits of the controlled foreign corpora-

1 *tion which are attributable to dividends received*
 2 *from a noncontrolled section 902 corporation*
 3 *may be treated as income in a separate category.*

4 *“(C) SPECIAL RULES.—For purposes of this*
 5 *paragraph—*

6 *“(i) EARNINGS AND PROFITS.—*

7 *“(I) IN GENERAL.—The rules of*
 8 *section 316 shall apply.*

9 *“(II) REGULATIONS.—The Sec-*
 10 *retary may prescribe regulations re-*
 11 *garding the treatment of distributions*
 12 *out of earnings and profits for periods*
 13 *before the taxpayer’s acquisition of the*
 14 *stock to which the distributions relate.*

15 *“(ii) INADEQUATE SUBSTANTIATION.—*
 16 *If the Secretary determines that the proper*
 17 *subparagraph of paragraph (1) in which a*
 18 *dividend is described has not been substan-*
 19 *tiated, such dividend shall be treated as in-*
 20 *come described in paragraph (1)(A).*

21 *“(iii) COORDINATION WITH HIGH-*
 22 *TAXED INCOME PROVISIONS.—Rules similar*
 23 *to the rules of paragraph (3)(F) shall apply*
 24 *for purposes of this paragraph.*

1 “(iv) *LOOK-THRU WITH RESPECT TO*
 2 *CARRYOVER OF CREDIT.*—Rules similar to
 3 subparagraph (A) also shall apply to any
 4 carryforward under subsection (c) from a
 5 taxable year beginning before January 1,
 6 2003, of tax allocable to a dividend from a
 7 noncontrolled section 902 corporation with
 8 respect to the taxpayer. The Secretary may
 9 by regulations provide for the allocation of
 10 any carryback of tax allocable to a dividend
 11 from a noncontrolled section 902 corpora-
 12 tion to such a taxable year for purposes of
 13 allocating such dividend among the separate
 14 categories in effect for such taxable year.”.

15 (b) *CONFORMING AMENDMENTS.*—

16 (1) Subparagraph (E) of section 904(d)(1) is
 17 hereby repealed.

18 (2) Section 904(d)(2)(C)(iii) is amended by add-
 19 ing “and” at the end of subclause (I), by striking sub-
 20 clause (II), and by redesignating subclause (III) as
 21 subclause (II).

22 (3) The last sentence of section 904(d)(2)(D) is
 23 amended to read as follows: “Such term does not in-
 24 clude any financial services income.”.

25 (4) Section 904(d)(2)(E) is amended—

1 (A) by inserting “or (4)” after “paragraph
2 (3)” in clause (i), and

3 (B) by striking clauses (ii) and (iv) and by
4 redesignating clause (iii) as clause (ii).

5 (5) Section 904(d)(3)(F) is amended by striking
6 “(D), or (E)” and inserting “or (D)”.

7 (6) Section 864(d)(5)(A)(i) is amended by strik-
8 ing “(C)(iii)(III)” and inserting “(C)(iii)(II)”.

9 (c) *EFFECTIVE DATE.*—The amendments made by this
10 section shall apply to taxable years beginning after Decem-
11 ber 31, 2002.

12 **SEC. 203. FOREIGN TAX CREDIT UNDER ALTERNATIVE MIN-**
13 **IMUM TAX.**

14 (a) *IN GENERAL.*—

15 (1) Subsection (a) of section 59 is amended by
16 striking paragraph (2) and by redesignating para-
17 graphs (3) and (4) as paragraphs (2) and (3), respec-
18 tively.

19 (2) Section 53(d)(1)(B)(i)(II) is amended by
20 striking “and if section 59(a)(2) did not apply”.

21 (b) *EFFECTIVE DATE.*—The amendments made by this
22 section shall apply to taxable years beginning after Decem-
23 ber 31, 2004.

1 **SEC. 204. RECHARACTERIZATION OF OVERALL DOMESTIC**
 2 **LOSS.**

3 (a) *GENERAL RULE.*—Section 904 is amended by re-
 4 designating subsections (g), (h), (i), (j), and (k) as sub-
 5 sections (h), (i), (j), (k), and (l) respectively, and by insert-
 6 ing after subsection (f) the following new subsection:

7 “(g) *RECHARACTERIZATION OF OVERALL DOMESTIC*
 8 *LOSS.*—

9 “(1) *GENERAL RULE.*—For purposes of this sub-
 10 part and section 936, in the case of any taxpayer who
 11 sustains an overall domestic loss for any taxable year
 12 beginning after December 31, 2006, that portion of
 13 the taxpayer’s taxable income from sources within the
 14 United States for each succeeding taxable year which
 15 is equal to the lesser of—

16 “(A) the amount of such loss (to the extent
 17 not used under this paragraph in prior taxable
 18 years), or

19 “(B) 50 percent of the taxpayer’s taxable
 20 income from sources within the United States for
 21 such succeeding taxable year,
 22 shall be treated as income from sources without the
 23 United States (and not as income from sources within
 24 the United States).

25 “(2) *OVERALL DOMESTIC LOSS DEFINED.*—For
 26 purposes of this subsection—

1 “(A) *IN GENERAL.*—The term ‘overall do-
 2 mestic loss’ means any domestic loss to the extent
 3 such loss offsets taxable income from sources
 4 without the United States for the taxable year or
 5 for any preceding taxable year by reason of a
 6 carryback. For purposes of the preceding sen-
 7 tence, the term ‘domestic loss’ means the amount
 8 by which the gross income for the taxable year
 9 from sources within the United States is exceeded
 10 by the sum of the deductions properly appor-
 11 tioned or allocated thereto (determined without
 12 regard to any carryback from a subsequent tax-
 13 able year).

14 “(B) *TAXPAYER MUST HAVE ELECTED FOR-*
 15 *EIGN TAX CREDIT FOR YEAR OF LOSS.*—The term
 16 ‘overall domestic loss’ shall not include any loss
 17 for any taxable year unless the taxpayer chose
 18 the benefits of this subpart for such taxable year.

19 “(3) *CHARACTERIZATION OF SUBSEQUENT IN-*
 20 *COME.*—

21 “(A) *IN GENERAL.*—Any income from
 22 sources within the United States that is treated
 23 as income from sources without the United
 24 States under paragraph (1) shall be allocated
 25 among and increase the income categories in

1 proportion to the loss from sources within the
2 United States previously allocated to those in-
3 come categories.

4 “(B) INCOME CATEGORY.—For purposes of
5 this paragraph, the term ‘income category’ has
6 the meaning given such term by subsection
7 (f)(5)(E)(i).

8 “(4) COORDINATION WITH SUBSECTION (f).—The
9 Secretary shall prescribe such regulations as may be
10 necessary to coordinate the provisions of this sub-
11 section with the provisions of subsection (f).”.

12 (b) CONFORMING AMENDMENTS.—

13 (1) Section 535(d)(2) is amended by striking
14 “section 904(g)(6)” and inserting “section 904(h)(6)”.

15 (2) Subparagraph (A) of section 936(a)(2) is
16 amended by striking “section 904(f)” and inserting
17 “subsections (f) and (g) of section 904”.

18 (c) EFFECTIVE DATE.—The amendments made by this
19 section shall apply to losses for taxable years beginning
20 after December 31, 2006.

21 **SEC. 205. INTEREST EXPENSE ALLOCATION RULES.**

22 (a) ELECTION TO ALLOCATE ON WORLDWIDE
23 BASIS.—Section 864 is amended by redesignating sub-
24 section (f) as subsection (g) and by inserting after sub-
25 section (e) the following new subsection:

1 “(f) *ELECTION TO ALLOCATE INTEREST, ETC. ON*
 2 *WORLDWIDE BASIS.—For purposes of this subchapter, at*
 3 *the election of the worldwide affiliated group—*

4 “(1) *ALLOCATION AND APPORTIONMENT OF IN-*
 5 *TEREST EXPENSE.—*

6 “(A) *IN GENERAL.—The taxable income of*
 7 *each domestic corporation which is a member of*
 8 *a worldwide affiliated group shall be determined*
 9 *by allocating and apportioning interest expense*
 10 *of each member as if all members of such group*
 11 *were a single corporation.*

12 “(B) *TREATMENT OF WORLDWIDE AFFILI-*
 13 *ATED GROUP.—The taxable income of the domes-*
 14 *tic members of a worldwide affiliated group from*
 15 *sources outside the United States shall be deter-*
 16 *mined by allocating and apportioning the inter-*
 17 *est expense of such domestic members to such in-*
 18 *come in an amount equal to the excess (if any)*
 19 *of—*

20 “(i) *the total interest expense of the*
 21 *worldwide affiliated group multiplied by*
 22 *the ratio which the foreign assets of the*
 23 *worldwide affiliated group bears to all the*
 24 *assets of the worldwide affiliated group,*
 25 *over*

1 “(ii) the interest expense of all foreign
2 corporations which are members of the
3 worldwide affiliated group to the extent
4 such interest expense of such foreign cor-
5 porations would have been allocated and
6 apportioned to foreign source income if this
7 subsection were applied to a group con-
8 sisting of all the foreign corporations in
9 such worldwide affiliated group.

10 “(C) WORLDWIDE AFFILIATED GROUP.—For
11 purposes of this paragraph, the term ‘worldwide
12 affiliated group’ means a group consisting of—

13 “(i) the includible members of an af-
14 filiated group (as defined in section
15 1504(a), determined without regard to
16 paragraphs (2) and (4) of section 1504(b)),
17 and

18 “(ii) all controlled foreign corporations
19 in which such members in the aggregate
20 meet the ownership requirements of section
21 1504(a)(2) either directly or indirectly
22 through applying paragraph (2) of section
23 958(a) or through applying rules similar to
24 the rules of such paragraph to stock owned

1 *directly or indirectly by domestic partner-*
 2 *ships, trusts, or estates.*

3 “(2) *ALLOCATION AND APPORTIONMENT OF*
 4 *OTHER EXPENSES.—Expenses other than interest*
 5 *which are not directly allocable or apportioned to any*
 6 *specific income producing activity shall be allocated*
 7 *and apportioned as if all members of the affiliated*
 8 *group were a single corporation. For purposes of the*
 9 *preceding sentence, the term ‘affiliated group’ has the*
 10 *meaning given such term by section 1504 (determined*
 11 *without regard to paragraph (4) of section 1504(b)).*

12 “(3) *TREATMENT OF TAX-EXEMPT ASSETS; BASIS*
 13 *OF STOCK IN NONAFFILIATED 10-PERCENT OWNED*
 14 *CORPORATIONS.—The rules of paragraphs (3) and (4)*
 15 *of subsection (e) shall apply for purposes of this sub-*
 16 *section, except that paragraph (4) shall be applied on*
 17 *a worldwide affiliated group basis.*

18 “(4) *TREATMENT OF CERTAIN FINANCIAL INSTI-*
 19 *TUTIONS.—*

20 “(A) *IN GENERAL.—For purposes of para-*
 21 *graph (1), any corporation described in subpara-*
 22 *graph (B) shall be treated as an includible cor-*
 23 *poration for purposes of section 1504 only for*
 24 *purposes of applying this subsection separately*
 25 *to corporations so described.*

1 “(B) *DESCRIPTION.*—A corporation is de-
2 scribed in this subparagraph if—

3 “(i) such corporation is a financial in-
4 stitution described in section 581 or 591,

5 “(ii) the business of such financial in-
6 stitution is predominantly with persons
7 other than related persons (within the
8 meaning of subsection (d)(4)) or their cus-
9 tomers, and

10 “(iii) such financial institution is re-
11 quired by State or Federal law to be oper-
12 ated separately from any other entity which
13 is not such an institution.

14 “(C) *TREATMENT OF BANK AND FINANCIAL*
15 *HOLDING COMPANIES.*—To the extent provided in
16 regulations—

17 “(i) a bank holding company (within
18 the meaning of section 2(a) of the Bank
19 Holding Company Act of 1956 (12 U.S.C.
20 1841(a)),

21 “(ii) a financial holding company
22 (within the meaning of section 2(p) of the
23 Bank Holding Company Act of 1956 (12
24 U.S.C. 1841(p)), and

1 “(iii) any subsidiary of a financial in-
 2 stitution described in section 581 or 591, or
 3 of any such bank or financial holding com-
 4 pany, if such subsidiary is predominantly
 5 engaged (directly or indirectly) in the active
 6 conduct of a banking, financing, or similar
 7 business,

8 shall be treated as a corporation described in
 9 subparagraph (B).

10 “(5) ELECTION TO EXPAND FINANCIAL INSTITU-
 11 TION GROUP OF WORLDWIDE GROUP.—

12 “(A) IN GENERAL.—If a worldwide affili-
 13 ated group elects the application of this sub-
 14 section, all financial corporations which—

15 “(i) are members of such worldwide af-
 16 filiated group, but

17 “(ii) are not corporations described in
 18 paragraph (4)(B),

19 shall be treated as described in paragraph (4)(B)
 20 for purposes of applying paragraph (4)(A). This
 21 subsection (other than this paragraph) shall
 22 apply to any such group in the same manner as
 23 this subsection (other than this paragraph) ap-
 24 plies to the pre-election worldwide affiliated
 25 group of which such group is a part.

1 “(B) *FINANCIAL CORPORATION.*—For pur-
 2 poses of this paragraph, the term ‘financial cor-
 3 poration’ means any corporation if at least 80
 4 percent of its gross income is income described in
 5 section 904(d)(2)(C)(ii) and the regulations
 6 thereunder which is derived from transactions
 7 with persons who are not related (within the
 8 meaning of section 267(b) or 707(b)(1)) to the
 9 corporation. For purposes of the preceding sen-
 10 tence, there shall be disregarded any item of in-
 11 come or gain from a transaction or series of
 12 transactions a principal purpose of which is the
 13 qualification of any corporation as a financial
 14 corporation.

15 “(C) *ANTIABUSE RULES.*—In the case of a
 16 corporation which is a member of an electing fi-
 17 nancial institution group, to the extent that such
 18 corporation—

19 “(i) distributes dividends or makes
 20 other distributions with respect to its stock
 21 after the date of the enactment of this para-
 22 graph to any member of the pre-election
 23 worldwide affiliated group (other than to a
 24 member of the electing financial institution
 25 group) in excess of the greater of—

1 “(I) its average annual dividend
2 (expressed as a percentage of current
3 earnings and profits) during the 5-tax-
4 able-year period ending with the tax-
5 able year preceding the taxable year, or

6 “(II) 25 percent of its average an-
7 nual earnings and profits for such 5-
8 taxable-year period, or

9 “(ii) deals with any person in any
10 manner not clearly reflecting the income of
11 the corporation (as determined under prin-
12 ciples similar to the principles of section
13 482),

14 an amount of indebtedness of the electing finan-
15 cial institution group equal to the excess dis-
16 tribution or the understatement or overstatement
17 of income, as the case may be, shall be re-
18 characterized (for the taxable year and subse-
19 quent taxable years) for purposes of this para-
20 graph as indebtedness of the worldwide affiliated
21 group (excluding the electing financial institu-
22 tion group). If a corporation has not been in ex-
23 istence for 5 taxable years, this subparagraph
24 shall be applied with respect to the period it was
25 in existence.

1 “(D) *ELECTION*.—An election under this
 2 paragraph with respect to any financial institu-
 3 tion group may be made only by the common
 4 parent of the pre-election worldwide affiliated
 5 group and may be made only for the first taxable
 6 year beginning after December 31, 2008, in
 7 which such affiliated group includes 1 or more
 8 financial corporations. Such an election, once
 9 made, shall apply to all financial corporations
 10 which are members of the electing financial in-
 11 stitution group for such taxable year and all
 12 subsequent years unless revoked with the consent
 13 of the Secretary.

14 “(E) *DEFINITIONS RELATING TO GROUPS*.—
 15 For purposes of this paragraph—

16 “(i) *PRE-ELECTION WORLDWIDE AF-*
 17 *FILIATED GROUP*.—The term ‘pre-election
 18 worldwide affiliated group’ means, with re-
 19 spect to a corporation, the worldwide affili-
 20 ated group of which such corporation would
 21 (but for an election under this paragraph)
 22 be a member for purposes of applying para-
 23 graph (1).

24 “(ii) *ELECTING FINANCIAL INSTITU-*
 25 *TION GROUP*.—The term ‘electing financial

1 *institution group' means the group of cor-*
 2 *porations to which this subsection applies*
 3 *separately by reason of the application of*
 4 *paragraph (4)(A) and which includes finan-*
 5 *cial corporations by reason of an election*
 6 *under subparagraph (A).*

7 *“(F) REGULATIONS.—The Secretary shall*
 8 *prescribe such regulations as may be appropriate*
 9 *to carry out this subsection, including regula-*
 10 *tions—*

11 *“(i) providing for the direct allocation*
 12 *of interest expense in other circumstances*
 13 *where such allocation would be appropriate*
 14 *to carry out the purposes of this subsection,*

15 *“(ii) preventing assets or interest ex-*
 16 *pense from being taken into account more*
 17 *than once, and*

18 *“(iii) dealing with changes in members*
 19 *of any group (through acquisitions or other-*
 20 *wise) treated under this paragraph as an*
 21 *affiliated group for purposes of this sub-*
 22 *section.*

23 *“(6) ELECTION.—An election to have this sub-*
 24 *section apply with respect to any worldwide affiliated*
 25 *group may be made only by the common parent of the*

1 *domestic affiliated group referred to in paragraph*
 2 *(1)(C) and may be made only for the first taxable*
 3 *year beginning after December 31, 2008, in which a*
 4 *worldwide affiliated group exists which includes such*
 5 *affiliated group and at least 1 foreign corporation.*
 6 *Such an election, once made, shall apply to such com-*
 7 *mon parent and all other corporations which are*
 8 *members of such worldwide affiliated group for such*
 9 *taxable year and all subsequent years unless revoked*
 10 *with the consent of the Secretary.”.*

11 **(b) EXPANSION OF REGULATORY AUTHORITY.—***Para-*
 12 *graph (7) of section 864(e) is amended—*

13 *(1) by inserting before the comma at the end of*
 14 *subparagraph (B) “and in other circumstances where*
 15 *such allocation would be appropriate to carry out the*
 16 *purposes of this subsection”, and*

17 *(2) by striking “and” at the end of subpara-*
 18 *graph (E), by redesignating subparagraph (F) as sub-*
 19 *paragraph (G), and by inserting after subparagraph*
 20 *(E) the following new subparagraph:*

21 *“(F) preventing assets or interest expense*
 22 *from being taken into account more than once,*
 23 *and”.*

1 (c) *EFFECTIVE DATE.*—The amendments made by this
 2 section shall apply to taxable years beginning after Decem-
 3 ber 31, 2008.

4 **SEC. 206. DETERMINATION OF FOREIGN PERSONAL HOLD-**
 5 **ING, COMPANY INCOME WITH RESPECT TO**
 6 **TRANSACTIONS IN COMMODITIES.**

7 (a) *IN GENERAL.*—Clauses (i) and (ii) of section
 8 954(c)(1)(C) (relating to commodity transactions) are
 9 amended to read as follows:

10 “(i) arise out of commodity hedging
 11 transactions (as defined in paragraph
 12 (4)(A)),

13 “(ii) are active business gains or losses
 14 from the sale of commodities, but only if
 15 substantially all of the controlled foreign
 16 corporation’s commodities are property de-
 17 scribed in paragraph (1), (2), or (8) of sec-
 18 tion 1221(a), or”.

19 (b) *DEFINITION AND SPECIAL RULES.*—Subsection (c)
 20 of section 954 is amended by adding after paragraph (3)
 21 the following new paragraph:

22 “(4) *DEFINITION AND SPECIAL RULES RELATING*
 23 *TO COMMODITY TRANSACTIONS.*—

24 “(A) *COMMODITY HEDGING TRANS-*
 25 *ACTIONS.*—For purposes of paragraph (1)(C)(i),

1 the term 'commodity hedging transaction' means
 2 any transaction with respect to a commodity if
 3 such transaction—

4 “(i) is a hedging transaction as de-
 5 fined in section 1221(b)(2), determined—

6 “(I) without regard to subpara-
 7 graph (A)(ii) thereof,

8 “(II) by applying subparagraph
 9 (A)(i) thereof by substituting 'ordinary
 10 property or property described in sec-
 11 tion 1231(b)' for 'ordinary property',
 12 and

13 “(III) by substituting 'controlled
 14 foreign corporation' for 'taxpayer' each
 15 place it appears, and

16 “(ii) is clearly identified as such in ac-
 17 cordance with section 1221(a)(7).

18 “(B) TREATMENT OF DEALER ACTIVITIES
 19 UNDER PARAGRAPH (1)(C).—Commodities with
 20 respect to which gains and losses are not taken
 21 into account under paragraph (2)(C) in com-
 22 puting a controlled foreign corporation's foreign
 23 personal holding company income shall not be
 24 taken into account in applying the substantially

1 all test under paragraph (1)(C)(ii) to such cor-
2 poration.

3 “(C) REGULATIONS.—The Secretary shall
4 prescribe such regulations as are appropriate to
5 carry out the purposes of paragraph (1)(C) in
6 the case of transactions involving related par-
7 ties.”.

8 (c) MODIFICATION OF EXCEPTION FOR DEALERS.—
9 Clause (i) of section 954(c)(2)(C) is amended by inserting
10 “and transactions involving physical settlement” after “(in-
11 cluding hedging transactions”.

12 (d) EFFECTIVE DATE.—The amendments made by this
13 section shall apply to transactions entered into after Decem-
14 ber 31, 2004.

15 **Subtitle B—International Tax** 16 **Simplification**

17 **SEC. 211. REPEAL OF FOREIGN PERSONAL HOLDING COM-** 18 **PANY RULES AND FOREIGN INVESTMENT** 19 **COMPANY RULES.**

20 (a) GENERAL RULE.—The following provisions are
21 hereby repealed:

22 (1) Part III of subchapter G of chapter 1 (relat-
23 ing to foreign personal holding companies).

24 (2) Section 1246 (relating to gain on foreign in-
25 vestment company stock).

1 (3) Section 1247 (relating to election by foreign
2 investment companies to distribute income currently).

3 (b) EXEMPTION OF FOREIGN CORPORATIONS FROM
4 PERSONAL HOLDING COMPANY RULES.—

5 (1) IN GENERAL.—Subsection (c) of section 542
6 (relating to exceptions) is amended—

7 (A) by striking paragraph (5) and inserting
8 the following:

9 “(5) a foreign corporation,”

10 (B) by striking paragraphs (7) and (10)
11 and by redesignating paragraphs (8) and (9) as
12 paragraphs (7) and (8), respectively,

13 (C) by inserting “and” at the end of para-
14 graph (7) (as so redesignated), and

15 (D) by striking “; and” at the end of para-
16 graph (8) (as so redesignated) and inserting a
17 period.

18 (2) TREATMENT OF INCOME FROM PERSONAL
19 SERVICE CONTRACTS.—Paragraph (1) of section
20 954(c) is amended by adding at the end the following
21 new subparagraph:

22 “(I) PERSONAL SERVICE CONTRACTS.—

23 “(i) Amounts received under a contract
24 under which the corporation is to furnish
25 personal services if—

1 “(I) some person other than the
2 corporation has the right to designate
3 (by name or by description) the indi-
4 vidual who is to perform the services,
5 or

6 “(II) the individual who is to per-
7 form the services is designated (by
8 name or by description) in the con-
9 tract, and

10 “(ii) amounts received from the sale or
11 other disposition of such a contract.

12 This subparagraph shall apply with respect to
13 amounts received for services under a particular
14 contract only if at some time during the taxable
15 year 25 percent or more in value of the out-
16 standing stock of the corporation is owned, di-
17 rectly or indirectly, by or for the individual who
18 has performed, is to perform, or may be des-
19 ignated (by name or by description) as the one
20 to perform, such services.”.

21 (c) CONFORMING AMENDMENTS.—

22 (1) Section 1(h) is amended—

23 (A) in paragraph (10), by inserting “and”
24 at the end of subparagraph (F), by striking sub-

1 paragraph (G), and by redesignating subpara-
 2 graph (H) as subparagraph (G), and

3 (B) by striking “a foreign personal holding
 4 company (as defined in section 552), a foreign
 5 investment company (as defined in section
 6 1246(b)), or” in paragraph (11)(C)(iii).

7 (2) Section 163(e)(3)(B), as amended by this
 8 Act, is amended by striking “which is a foreign per-
 9 sonal holding company (as defined in section 552), a
 10 controlled foreign corporation (as defined in section
 11 957), or” and inserting “which is a controlled foreign
 12 corporation (as defined in section 957) or”.

13 (3) Paragraph (2) of section 171(c) is amend-
 14 ed—

15 (A) by striking “, or by a foreign personal
 16 holding company, as defined in section 552”,
 17 and

18 (B) by striking “, or foreign personal hold-
 19 ing company”.

20 (4) Paragraph (2) of section 245(a) is amended
 21 by striking “foreign personal holding company or”.

22 (5) Section 267(a)(3)(B), as amended by this
 23 Act, is amended by striking “to a foreign personal
 24 holding company (as defined in section 552), a con-
 25 trolled foreign corporation (as defined in section 957),

1 or” and inserting “to a controlled foreign corporation
2 (as defined in section 957) or”.

3 (6) Section 312 is amended by striking sub-
4 section (j).

5 (7) Subsection (m) of section 312 is amended by
6 striking “, a foreign investment company (within the
7 meaning of section 1246(b)), or a foreign personal
8 holding company (within the meaning of section
9 552)”.

10 (8) Subsection (e) of section 443 is amended by
11 striking paragraph (3) and by redesignating para-
12 graphs (4) and (5) as paragraphs (3) and (4), respec-
13 tively.

14 (9) Subparagraph (B) of section 465(c)(7) is
15 amended by adding “or” at the end of clause (i), by
16 striking clause (ii), and by redesignating clause (iii)
17 as clause (ii).

18 (10) Paragraph (1) of section 543(b) is amended
19 by inserting “and” at the end of subparagraph (A),
20 by striking “, and” at the end of subparagraph (B)
21 and inserting a period, and by striking subparagraph
22 (C).

23 (11) Paragraph (1) of section 562(b) is amended
24 by striking “or a foreign personal holding company
25 described in section 552”.

1 (12) Section 563 is amended—

2 (A) by striking subsection (c),

3 (B) by redesignating subsection (d) as sub-
4 section (c), and

5 (C) by striking “subsection (a), (b), or (c)”
6 in subsection (c) (as so redesignated) and insert-
7 ing “subsection (a) or (b)”.

8 (13) Subsection (d) of section 751 is amended by
9 adding “and” at the end of paragraph (2), by strik-
10 ing paragraph (3), by redesignating paragraph (4) as
11 paragraph (3), and by striking “paragraph (1), (2),
12 or (3)” in paragraph (3) (as so redesignated) and in-
13 serting “paragraph (1) or (2)”.

14 (14) Paragraph (2) of section 864(d) is amended
15 by striking subparagraph (A) and by redesignating
16 subparagraphs (B) and (C) as subparagraphs (A)
17 and (B), respectively.

18 (15)(A) Subparagraph (A) of section 898(b)(1) is
19 amended to read as follows:

20 “(A) which is treated as a controlled foreign
21 corporation for any purpose under subpart F of
22 part III of this subchapter, and”.

23 (B) Subparagraph (B) of section 898(b)(2) is
24 amended by striking “and sections 551(f) and 554,
25 whichever are applicable,”.

1 (C) Paragraph (3) of section 898(b) is amended
2 to read as follows:

3 “(3) UNITED STATES SHAREHOLDER.—The term
4 ‘United States shareholder’ has the meaning given to
5 such term by section 951(b), except that, in the case
6 of a foreign corporation having related person insur-
7 ance income (as defined in section 953(c)(2)), the Sec-
8 retary may treat any person as a United States
9 shareholder for purposes of this section if such person
10 is treated as a United States shareholder under sec-
11 tion 953(c)(1).”.

12 (D) Subsection (c) of section 898 is amended to
13 read as follows:

14 “(c) DETERMINATION OF REQUIRED YEAR.—

15 “(1) IN GENERAL.—The required year is—

16 “(A) the majority U.S. shareholder year, or

17 “(B) if there is no majority U.S. share-
18 holder year, the taxable year prescribed under
19 regulations.

20 “(2) 1-MONTH DEFERRAL ALLOWED.—A specified
21 foreign corporation may elect, in lieu of the taxable
22 year under paragraph (1)(A), a taxable year begin-
23 ning 1 month earlier than the majority U.S. share-
24 holder year.

25 “(3) MAJORITY U.S. SHAREHOLDER YEAR.—

1 “(A) *IN GENERAL.*—For purposes of this
 2 subsection, the term ‘majority U.S. shareholder
 3 year’ means the taxable year (if any) which, on
 4 each testing day, constituted the taxable year
 5 of—

6 “(i) each United States shareholder de-
 7 scribed in subsection (b)(2)(A), and

8 “(ii) each United States shareholder
 9 not described in clause (i) whose stock was
 10 treated as owned under subsection (b)(2)(B)
 11 by any shareholder described in such clause.

12 “(B) *TESTING DAY.*—The testing days shall
 13 be—

14 “(i) the first day of the corporation’s
 15 taxable year (determined without regard to
 16 this section), or

17 “(ii) the days during such representa-
 18 tive period as the Secretary may pre-
 19 scribe.”.

20 (16) Clause (ii) of section 904(d)(2)(A) is
 21 amended to read as follows:

22 “(ii) *CERTAIN AMOUNTS INCLUDED.*—
 23 Except as provided in clause (iii), the term
 24 ‘passive income’ includes, except as pro-
 25 vided in subparagraph (E)(iii) or para-

1 “(3) *SPECIAL RULES ON CARRYBACKS.*—A net
2 *capital loss of a corporation shall not be carried back*
3 *under paragraph (1)(A) to a taxable year—*

4 “(A) *for which it is a regulated investment*
5 *company (as defined in section 851), or*

6 “(B) *for which it is a real estate investment*
7 *trust (as defined in section 856).”.*

8 “(B) *The amendment made by subparagraph (A)*
9 *shall apply to taxable years beginning after December*
10 *31, 2004.*

11 “(23) *Section 1223 is amended by striking para-*
12 *graph (10) and by redesignating the following para-*
13 *graphs accordingly.*

14 “(24) *Subsection (d) of section 1248 is amended*
15 *by striking paragraph (5) and by redesignating para-*
16 *graphs (6) and (7) as paragraphs (5) and (6), respec-*
17 *tively.*

18 “(25) *Paragraph (2) of section 1260(c) is amend-*
19 *ed by striking subparagraphs (H) and (I) and by re-*
20 *designating subparagraph (J) as subparagraph (H).*

21 “(26)(A) *Subparagraph (F) of section 1291(b)(3)*
22 *is amended by striking “551(d), 959(a),” and insert-*
23 *ing “959(a).”.*

24 “(B) *Subsection (e) of section 1291 is amended by*
25 *inserting “(as in effect on the day before the date of*

1 *the enactment of the Jumpstart Our Business*
 2 *Strength (JOBS) Act)” after “section 1246”.*

3 *(27) Paragraph (2) of section 1294(a) is amend-*
 4 *ed to read as follows:*

5 *“(2) ELECTION NOT PERMITTED WHERE*
 6 *AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION*
 7 *951.—The taxpayer may not make an election under*
 8 *paragraph (1) with respect to the undistributed PFIC*
 9 *earnings tax liability attributable to a qualified elect-*
 10 *ing fund for the taxable year if any amount is in-*
 11 *cludible in the gross income of the taxpayer under sec-*
 12 *tion 951 with respect to such fund for such taxable*
 13 *year.”.*

14 *(28) Section 6035 is hereby repealed.*

15 *(29) Subparagraph (D) of section 6103(e)(1) is*
 16 *amended by striking clause (iv) and redesignating*
 17 *clauses (v) and (vi) as clauses (iv) and (v), respec-*
 18 *tively.*

19 *(30) Subparagraph (B) of section 6501(e)(1) is*
 20 *amended to read as follows:*

21 *“(B) CONSTRUCTIVE DIVIDENDS.—If the*
 22 *taxpayer omits from gross income an amount*
 23 *properly includible therein under section 951(a),*
 24 *the tax may be assessed, or a proceeding in court*
 25 *for the collection of such tax may be done with-*

1 out assessing, at any time within 6 years after
2 the return was filed.”.

3 (31) Subsection (a) of section 6679 is amended—

4 (A) by striking “6035, 6046, and 6046A” in
5 paragraph (1) and inserting “6046 and 6046A”,
6 and

7 (B) by striking paragraph (3).

8 (32) Sections 170(f)(10)(A), 508(d), 4947, and
9 4948(c)(4) are each amended by striking “556(b)(2),”
10 each place it appears.

11 (33) The table of parts for subchapter G of chap-
12 ter 1 is amended by striking the item relating to part
13 III.

14 (34) The table of sections for part IV of sub-
15 chapter P of chapter 1 is amended by striking the
16 items relating to sections 1246 and 1247.

17 (35) The table of sections for subpart A of part
18 III of subchapter A of chapter 61 is amended by strik-
19 ing the item relating to section 6035.

20 (d) *EFFECTIVE DATE.*—The amendments made by this
21 section shall apply to taxable years of foreign corporations
22 beginning after December 31, 2004, and to taxable years
23 of United States shareholders with or within which such
24 taxable years of foreign corporations end.

1 **SEC. 212. EXPANSION OF DE MINIMIS RULE UNDER SUB-**
 2 **PART F.**

3 (a) *IN GENERAL.*—Clause (ii) of section 954(b)(3)(A)
 4 (relating to de minimis, etc., rules) is amended by striking
 5 “\$1,000,000” and inserting “\$5,000,000”.

6 (b) *TECHNICAL AMENDMENTS.*—

7 (1) Clause (ii) of section 864(d)(5)(A) is amend-
 8 ed by striking “\$1,000,000” and inserting
 9 “\$5,000,000”.

10 (2) Clause (i) of section 881(c)(5)(A) is amended
 11 by striking “\$1,000,000” and inserting “\$5,000,000”.

12 (c) *EFFECTIVE DATE.*—The amendments made by this
 13 section shall apply to taxable years of foreign corporations
 14 beginning after December 31, 2004, and to taxable years
 15 of United States shareholders with or within which such
 16 taxable years of foreign corporations end.

17 **SEC. 213. ATTRIBUTION OF STOCK OWNERSHIP THROUGH**
 18 **PARTNERSHIPS TO APPLY IN DETERMINING**
 19 **SECTION 902 AND 960 CREDITS.**

20 (a) *IN GENERAL.*—Subsection (c) of section 902 is
 21 amended by redesignating paragraph (7) as paragraph (8)
 22 and by inserting after paragraph (6) the following new
 23 paragraph:

24 “(7) *CONSTRUCTIVE OWNERSHIP THROUGH*
 25 *PARTNERSHIPS.*—Stock owned, directly or indirectly,
 26 by or for a partnership shall be considered as being

1 *owned proportionately by its partners. Stock consid-*
 2 *ered to be owned by a person by reason of the pre-*
 3 *ceding sentence shall, for purposes of applying such*
 4 *sentence, be treated as actually owned by such person.*
 5 *The Secretary may prescribe such regulations as may*
 6 *be necessary to carry out the purposes of this para-*
 7 *graph, including rules to account for special partner-*
 8 *ship allocations of dividends, credits, and other inci-*
 9 *dents of ownership of stock in determining propor-*
 10 *tionate ownership.”.*

11 *(b) CLARIFICATION OF COMPARABLE ATTRIBUTION*
 12 *UNDER SECTION 901(b)(5).—Paragraph (5) of section*
 13 *901(b) is amended by striking “any individual” and insert-*
 14 *ing “any person”.*

15 *(c) EFFECTIVE DATE.—The amendments made by this*
 16 *section shall apply to taxes of foreign corporations for tax-*
 17 *able years of such corporations beginning after the date of*
 18 *the enactment of this Act.*

19 **SEC. 214. APPLICATION OF UNIFORM CAPITALIZATION**
 20 **RULES TO FOREIGN PERSONS.**

21 *(a) IN GENERAL.—Section 263A(c) (relating to excep-*
 22 *tions) is amended by adding at the end the following new*
 23 *paragraph:*

24 *“(7) FOREIGN PERSONS.—Except for purposes of*
 25 *applying sections 871(b)(1) and 882(a)(1), this sec-*

1 *tion shall not apply to any taxpayer who is not a*
 2 *United States person if such taxpayer capitalizes*
 3 *costs of produced property or property acquired for*
 4 *resale by applying the method used to ascertain the*
 5 *income, profit, or loss for purposes of reports or state-*
 6 *ments to shareholders, partners, other proprietors, or*
 7 *beneficiaries, or for credit purposes.”.*

8 *(b) EFFECTIVE DATE.—*

9 *(1) IN GENERAL.—The amendment made by sub-*
 10 *section (a) shall apply to taxable years beginning*
 11 *after December 31, 2004.*

12 *(2) CHANGE IN METHOD OF ACCOUNTING.—In*
 13 *the case of any taxpayer required by the amendment*
 14 *made by this section to change its method of account-*
 15 *ing for its first taxable year beginning after December*
 16 *31, 2004—*

17 *(A) such change shall be treated as initiated*
 18 *by the taxpayer,*

19 *(B) such change shall be treated as made*
 20 *with the consent of the Secretary of the Treasury,*
 21 *and*

22 *(C) the net amount of the adjustments re-*
 23 *quired to be taken into account by the taxpayer*
 24 *under section 481 of the Internal Revenue Code*

1 of 1986 shall be taken into account in such first
2 year.

3 **SEC. 215. REPEAL OF WITHHOLDING TAX ON DIVIDENDS**
4 **FROM CERTAIN FOREIGN CORPORATIONS.**

5 (a) *IN GENERAL.*—Paragraph (2) of section 871(i) (re-
6 lating to tax not to apply to certain interest and dividends)
7 is amended by adding at the end the following new subpara-
8 graph:

9 “(D) Dividends paid by a foreign corpora-
10 tion which are treated under section
11 861(a)(2)(B) as income from sources within the
12 United States.”.

13 (b) *EFFECTIVE DATE.*—The amendment made by this
14 section shall apply to payments made after December 31,
15 2004.

16 **SEC. 216. REPEAL OF SPECIAL CAPITAL GAINS TAX ON**
17 **ALIENS PRESENT IN THE UNITED STATES**
18 **FOR 183 DAYS OR MORE.**

19 (a) *IN GENERAL.*—Subsection (a) of section 871 is
20 amended by striking paragraph (2) and by redesignating
21 paragraph (3) as paragraph (2).

22 (b) *CONFORMING AMENDMENT.*—Section 1441(g) is
23 amended is amended by striking “section 871(a)(3)” and
24 inserting “section 871(a)(2)”.

1 (c) *EFFECTIVE DATE.*—The amendments made by this
 2 section shall apply to taxable years beginning after Decem-
 3 ber 31, 2003.

4 **Subtitle C—Additional**
 5 **International Tax Provisions**

6 **SEC. 221. ACTIVE LEASING INCOME FROM AIRCRAFT AND**
 7 **VESSELS.**

8 (a) *IN GENERAL.*—Section 954(c)(2) is amended by
 9 adding at the end the following new subparagraph:

10 “(D) *CERTAIN RENTS, ETC.*—

11 “(i) *IN GENERAL.*—Foreign personal
 12 holding company income shall not include
 13 qualified leasing income derived from or in
 14 connection with the leasing or rental of any
 15 aircraft or vessel.

16 “(ii) *QUALIFIED LEASING INCOME.*—

17 For purposes of this subparagraph, the term
 18 ‘qualified leasing income’ means rents and
 19 gains derived in the active conduct of a
 20 trade or business of leasing with respect to
 21 which the controlled foreign corporation
 22 conducts substantial activity, but only if—

23 “(I) the leased property is used by
 24 the lessee or other end-user in foreign

1 commerce and predominantly outside
2 the United States, and

3 “(II) the lessee or other end-user
4 is not a related person (as defined in
5 subsection (d)(3)).

6 Any amount not treated as foreign personal
7 holding income under this subparagraph
8 shall not be treated as foreign base company
9 shipping income.”.

10 (b) CONFORMING AMENDMENT.—Section 954(c)(1)(B)
11 is amended by inserting “or (2)(D)” after “paragraph
12 (2)(A)”.

13 (c) EFFECTIVE DATE.—The amendments made by this
14 section shall apply to taxable years of foreign corporations
15 beginning after December 31, 2006, and to taxable years
16 of United States shareholders with or within which such
17 taxable years of foreign corporations end.

18 **SEC. 222. LOOK-THRU TREATMENT OF PAYMENTS BETWEEN**
19 **RELATED CONTROLLED FOREIGN CORPORA-**
20 **TIONS UNDER FOREIGN PERSONAL HOLDING**
21 **COMPANY INCOME RULES.**

22 (a) IN GENERAL.—Subsection (c) of section 954, as
23 amended by this Act, is amended by adding after para-
24 graph (4) the following new paragraph:

1 “(5) *LOOK-THRU IN THE CASE OF RELATED CON-*
 2 *TROLLED FOREIGN CORPORATIONS.*—For purposes of
 3 *this subsection, dividends, interest, rents, and royal-*
 4 *ties received or accrued from a controlled foreign cor-*
 5 *poration which is a related person (as defined in sub-*
 6 *section (b)(9)) shall not be treated as foreign personal*
 7 *holding company income to the extent attributable or*
 8 *properly allocable (determined under rules similar to*
 9 *the rules of subparagraphs (C) and (D) of section*
 10 *904(d)(3)) to income of the related person which is*
 11 *not subpart F income (as defined in section 952). The*
 12 *Secretary shall prescribe such regulations as may be*
 13 *appropriate to prevent the abuse of the purposes of*
 14 *this paragraph.”.*

15 **(b) EFFECTIVE DATE.**—The amendment made by this
 16 section shall apply to taxable years of foreign corporations
 17 beginning after December 31, 2004, and to taxable years
 18 of United States shareholders with or within which such
 19 taxable years of foreign corporations end.

20 **SEC. 223. LOOK-THRU TREATMENT FOR SALES OF PART-**
 21 **nership INTERESTS.**

22 **(a) IN GENERAL.**—Section 954(c) (defining foreign
 23 personal holding company income), as amended by this Act,
 24 is amended by adding after paragraph (5) the following
 25 new paragraph:

1 “(6) LOOK-THRU RULE FOR CERTAIN PARTNER-
2 SHIP SALES.—

3 “(A) IN GENERAL.—In the case of any sale
4 by a controlled foreign corporation of an interest
5 in a partnership with respect to which such cor-
6 poration is a 25-percent owner, such corporation
7 shall be treated for purposes of this subsection as
8 selling the proportionate share of the assets of the
9 partnership attributable to such interest. The
10 Secretary shall prescribe such regulations as
11 may be appropriate to prevent abuse of the pur-
12 poses of this paragraph, including regulations
13 providing for coordination of this paragraph
14 with the provisions of subchapter K.

15 “(B) 25-PERCENT OWNER.—For purposes of
16 this paragraph, the term ‘25-percent owner’
17 means a controlled foreign corporation which
18 owns directly 25 percent or more of the capital
19 or profits interest in a partnership. For purposes
20 of the preceding sentence, if a controlled foreign
21 corporation is a shareholder or partner of a cor-
22 poration or partnership, the controlled foreign
23 corporation shall be treated as owning directly
24 its proportionate share of any such capital or

1 profits interest held directly or indirectly by such
2 corporation or partnership”.

3 (b) *EFFECTIVE DATE.*—The amendment made by this
4 section shall apply to taxable years of foreign corporations
5 beginning after December 31, 2004, and to taxable years
6 of United States shareholders with or within which such
7 taxable years of foreign corporations end.

8 **SEC. 224. ELECTION NOT TO USE AVERAGE EXCHANGE**
9 **RATE FOR FOREIGN TAX PAID OTHER THAN**
10 **IN FUNCTIONAL CURRENCY.**

11 (a) *IN GENERAL.*—Paragraph (1) of section 986(a)
12 (relating to determination of foreign taxes and foreign cor-
13 poration’s earnings and profits) is amended by redesign-
14 ating subparagraph (D) as subparagraph (E) and by in-
15 serting after subparagraph (C) the following new subpara-
16 graph:

17 “(D) *ELECTIVE EXCEPTION FOR TAXES*
18 *PAID OTHER THAN IN FUNCTIONAL CURRENCY.*—

19 “(i) *IN GENERAL.*—At the election of
20 the taxpayer, subparagraph (A) shall not
21 apply to any foreign income taxes the li-
22 ability for which is denominated in any
23 currency other than in the taxpayer’s func-
24 tional currency.

1 “(ii) *APPLICATION TO QUALIFIED*
 2 *BUSINESS UNITS.*—An election under this
 3 subparagraph may apply to foreign income
 4 taxes attributable to a qualified business
 5 unit in accordance with regulations pre-
 6 scribed by the Secretary.

7 “(iii) *ELECTION.*—Any such election
 8 shall apply to the taxable year for which
 9 made and all subsequent taxable years un-
 10 less revoked with the consent of the Sec-
 11 retary.”.

12 (b) *EFFECTIVE DATE.*—The amendments made by this
 13 section shall apply to taxable years beginning after Decem-
 14 ber 31, 2004.

15 **SEC. 225. TREATMENT OF INCOME TAX BASE DIFFERENCES.**

16 (a) *IN GENERAL.*—Paragraph (2) of section 904(d) is
 17 amended by redesignating subparagraphs (H) and (I) as
 18 subparagraphs (I) and (J), respectively, and by inserting
 19 after subparagraph (G) the following new subparagraph:

20 “(H) *TREATMENT OF INCOME TAX BASE*
 21 *DIFFERENCES.*—

22 “(i) *IN GENERAL.*—A taxpayer may
 23 elect to treat tax imposed under the law of
 24 a foreign country or possession of the
 25 United States on an amount which does not

1 *constitute income under United States tax*
 2 *principles as tax imposed on income de-*
 3 *scribed in subparagraph (C) or (I) of para-*
 4 *graph (1).*

5 “(ii) *ELECTION IRREVOCABLE.—Any*
 6 *such election shall apply to the taxable year*
 7 *for which made and all subsequent taxable*
 8 *years unless revoked with the consent of the*
 9 *Secretary.”.*

10 (b) *EFFECTIVE DATE.—The amendments made by this*
 11 *section shall apply to taxable years ending after the date*
 12 *of the enactment of this Act.*

13 **SEC. 226. MODIFICATION OF EXCEPTIONS UNDER SUBPART**
 14 **F FOR ACTIVE FINANCING.**

15 (a) *IN GENERAL.—Section 954(h)(3) is amended by*
 16 *adding at the end the following:*

17 “(E) *DIRECT CONDUCT OF ACTIVITIES.—*
 18 *For purposes of subparagraph (A)(ii)(II), an ac-*
 19 *tivity shall be treated as conducted directly by*
 20 *an eligible controlled foreign corporation or*
 21 *qualified business unit in its home country if the*
 22 *activity is performed by employees of a related*
 23 *person and—*

24 “(i) *the related person is an eligible*
 25 *controlled foreign corporation the home*

1 country of which is the same as the home
 2 country of the corporation or unit to which
 3 subparagraph (A)(ii)(II) is being applied,

4 “(ii) the activity is performed in the
 5 home country of the related person, and

6 “(iii) the related person is compensated
 7 on an arm’s-length basis for the perform-
 8 ance of the activity by its employees and
 9 such compensation is treated as earned by
 10 such person in its home country for pur-
 11 poses of the home country’s tax laws.”.

12 (b) *EFFECTIVE DATE.*—The amendment made by this
 13 section shall apply to taxable years of such foreign corpora-
 14 tions beginning after December 31, 2004, and to taxable
 15 years of United States shareholders with or within which
 16 such taxable years of such foreign corporations end.

17 **SEC. 227. UNITED STATES PROPERTY NOT TO INCLUDE**
 18 **CERTAIN ASSETS OF CONTROLLED FOREIGN**
 19 **CORPORATION.**

20 (a) *IN GENERAL.*—Section 956(c)(2) (relating to ex-
 21 ceptions from property treated as United States property)
 22 is amended by striking “and” at the end of subparagraph
 23 (J), by striking the period at the end of subparagraph (K)
 24 and inserting a semicolon, and by adding at the end the
 25 following new subparagraphs:

1 “(L) securities acquired and held by a con-
2 trolled foreign corporation in the ordinary course
3 of its business as a dealer in securities if—

4 “(i) the dealer accounts for the securi-
5 ties as securities held primarily for sale to
6 customers in the ordinary course of busi-
7 ness, and

8 “(ii) the dealer disposes of the securi-
9 ties (or such securities mature while held by
10 the dealer) within a period consistent with
11 the holding of securities for sale to cus-
12 tomers in the ordinary course of business;
13 and

14 “(M) an obligation of a United States per-
15 son which—

16 “(i) is not a domestic corporation, and

17 “(ii) is not—

18 “(I) a United States shareholder
19 (as defined in section 951(b)) of the
20 controlled foreign corporation, or

21 “(II) a partnership, estate, or
22 trust in which the controlled foreign
23 corporation, or any related person (as
24 defined in section 954(d)(3)), is a
25 partner, beneficiary, or trustee imme-

1 diately after the acquisition of any ob-
 2 ligation of such partnership, estate, or
 3 trust by the controlled foreign corpora-
 4 tion.”.

5 (b) *CONFORMING AMENDMENT.*—Section 956(c)(2) is
 6 amended by striking “and (K)” in the last sentence and
 7 inserting “, (K), and (L)”.

8 (c) *EFFECTIVE DATE.*—The amendments made by this
 9 section shall apply to taxable years of foreign corporations
 10 beginning after December 31, 2004, and to taxable years
 11 of United States shareholders with or within which such
 12 taxable years of foreign corporations end.

13 **SEC. 228. PROVIDE EQUAL TREATMENT FOR INTEREST PAID**
 14 **BY FOREIGN PARTNERSHIPS AND FOREIGN**
 15 **CORPORATIONS.**

16 (a) *IN GENERAL.*—Paragraph (1) of section 861(a) is
 17 amended by striking “and” at the end of subparagraph (A),
 18 by striking the period at the end of subparagraph (B) and
 19 inserting “, and”, and by adding at the end the following
 20 new subparagraph:

21 “(C) in the case of a foreign partnership in
 22 which United States persons do not hold directly
 23 or indirectly 20 percent or more of either the
 24 capital or profits interests, any interest not paid
 25 by a trade or business engaged in by the partner-

1 *ship in the United States and not allocable to*
 2 *income which is effectively connected (or treated*
 3 *as effectively connected) with the conduct of a*
 4 *trade or business in the United States.”.*

5 **(b) EFFECTIVE DATE.**—*The amendments made by this*
 6 *section shall apply to taxable years beginning after Decem-*
 7 *ber 31, 2003.*

8 **SEC. 229. CLARIFICATION OF TREATMENT OF CERTAIN**
 9 **TRANSFERS OF INTANGIBLE PROPERTY.**

10 **(a) IN GENERAL.**—*Subparagraph (C) of section*
 11 *367(d)(2) is amended by adding at the end the following*
 12 *new sentence: “For purposes of applying section 904(d),*
 13 *any such amount shall be treated in the same manner as*
 14 *if such amount were a royalty.”.*

15 **(b) EFFECTIVE DATE.**—*The amendment made by this*
 16 *section shall apply to amounts treated as received pursuant*
 17 *to section 367(d)(2) of the Internal Revenue Code of 1986*
 18 *on or after August 5, 1997.*

19 **SEC. 230. MODIFICATION OF THE TREATMENT OF CERTAIN**
 20 **REIT DISTRIBUTIONS ATTRIBUTABLE TO**
 21 **GAIN FROM SALES OR EXCHANGES OF**
 22 **UNITED STATES REAL PROPERTY INTERESTS.**

23 **(a) IN GENERAL.**—*Paragraph (1) of section 897(h)*
 24 *(relating to look-through of distributions) is amended by*
 25 *adding at the end the following new sentence: “Notwith-*

1 *standing the preceding sentence, any distribution by a*
 2 *REIT with respect to any class of stock which is regularly*
 3 *traded on an established securities market located in the*
 4 *United States shall not be treated as gain recognized from*
 5 *the sale or exchange of a United States real property inter-*
 6 *est if the shareholder did not own more than 5 percent of*
 7 *such class of stock at any time during the taxable year.”.*

8 (b) *CONFORMING AMENDMENT.*—Paragraph (3) of sec-
 9 *tion 857(b) (relating to capital gains) is amended by add-*
 10 *ing at the end the following new subparagraph:*

11 “(F) *CERTAIN DISTRIBUTIONS.*—*In the case*
 12 *of a shareholder of a real estate investment trust*
 13 *to whom section 897 does not apply by reason of*
 14 *the second sentence of section 897(h)(1), the*
 15 *amount which would be included in computing*
 16 *long-term capital gains for such shareholder*
 17 *under subparagraph (B) or (D) (without regard*
 18 *to this subparagraph)—*

19 “(i) *shall not be included in computing*
 20 *such shareholder’s long-term capital gains,*
 21 *and*

22 “(ii) *shall be included in such share-*
 23 *holder’s gross income as a dividend from the*
 24 *real estate investment trust.”.*

1 (c) *EFFECTIVE DATE.*—The amendments made by this
 2 section shall apply to taxable years beginning after the date
 3 of the enactment of this Act.

4 **SEC. 231. TOLL TAX ON EXCESS QUALIFIED FOREIGN DIS-**
 5 **TRIBUTION AMOUNT.**

6 (a) *IN GENERAL.*—Subpart F of part III of subchapter
 7 N of chapter 1 is amended by adding at the end the fol-
 8 lowing new section:

9 **“SEC. 965. TOLL TAX IMPOSED ON EXCESS QUALIFIED FOR-**
 10 **EIGN DISTRIBUTION AMOUNT.**

11 “(a) *TOLL TAX IMPOSED ON EXCESS QUALIFIED FOR-*
 12 *EIGN DISTRIBUTION AMOUNT.*—If a corporation elects the
 13 application of this section, a tax shall be imposed on the
 14 taxpayer in an amount equal to 5.25 percent of—

15 “(1) the taxpayer’s excess qualified foreign dis-
 16 tribution amount, and
 17 “(2) the amount determined under section 78
 18 which is attributable to such excess qualified foreign
 19 distribution amount.

20 Such tax shall be imposed in lieu of the tax imposed under
 21 section 11 or 55 on the amounts described in paragraphs
 22 (1) and (2) for such taxable year.

23 “(b) *EXCESS QUALIFIED FOREIGN DISTRIBUTION*
 24 *AMOUNT.*—For purposes of this section—

1 “(1) *IN GENERAL.*—The term ‘excess qualified
2 *foreign distribution amount*’ means the excess (if any)
3 of—

4 “(A) the aggregate dividends received by the
5 taxpayer during the taxable year which are—

6 “(i) from 1 or more corporations which
7 are controlled foreign corporations in which
8 the taxpayer is a United States shareholder
9 on the date such dividends are paid, and

10 “(ii) described in a domestic reinvest-
11 ment plan which—

12 “(I) is approved by the taxpayer’s
13 president, chief executive officer, or
14 comparable official before the payment
15 of such dividends and subsequently ap-
16 proved by the taxpayer’s board of di-
17 rectors, management committee, execu-
18 tive committee, or similar body, and

19 “(II) provides for the reinvestment
20 of such dividends in the United States
21 (other than as payment for executive
22 compensation), including as a source
23 for the funding of worker hiring and
24 training, infrastructure, research and
25 development, capital investments, or

1 the financial stabilization of the cor-
 2 poration for the purposes of job reten-
 3 tion or creation, over

4 “(B) the base dividend amount.

5 “(2) *BASE DIVIDEND AMOUNT.*—The term ‘base
 6 dividend amount’ means an amount designated under
 7 subsection (c)(7), but not less than the average
 8 amount of dividends received during the fixed base
 9 period from 1 or more corporations which are con-
 10 trolled foreign corporations in which the taxpayer is
 11 a United States shareholder on the date such divi-
 12 dends are paid.

13 “(3) *FIXED BASE PERIOD.*—

14 “(A) *IN GENERAL.*—The term ‘fixed base pe-
 15 riod’ means each of 3 taxable years which are
 16 among the 5 most recent taxable years of the tax-
 17 payer ending on or before December 31, 2002,
 18 determined by disregarding—

19 “(i) the 1 taxable year for which the
 20 taxpayer had the highest amount of divi-
 21 dends from 1 or more corporations which
 22 are controlled foreign corporations relative
 23 to the other 4 taxable years, and

24 “(ii) the 1 taxable year for which the
 25 taxpayer had the lowest amount of divi-

1 *dends from such corporations relative to the*
 2 *other 4 taxable years.*

3 “(B) *SHORTER PERIOD.*—*If the taxpayer*
 4 *has fewer than 5 taxable years ending on or be-*
 5 *fore December 31, 2002, then in lieu of applying*
 6 *subparagraph (A), the fixed base period shall in-*
 7 *clude all the taxable years of the taxpayer ending*
 8 *on or before December 31, 2002.*

9 “(c) *DEFINITIONS AND SPECIAL RULES.*—*For pur-*
 10 *poses of this section—*

11 “(1) *DIVIDENDS.*—*The term ‘dividend’ has the*
 12 *meaning given such term by section 316, except that*
 13 *the term shall include amounts described in section*
 14 *951(a)(1)(B), but shall not include amounts described*
 15 *in sections 78 and 959.*

16 “(2) *CONTROLLED FOREIGN CORPORATIONS AND*
 17 *UNITED STATES SHAREHOLDERS.*—*The term ‘con-*
 18 *trolled foreign corporation’ has the meaning given*
 19 *such term by section 957(a) and the term ‘United*
 20 *States shareholder’ has the meaning given such term*
 21 *by section 951(b).*

22 “(3) *FOREIGN TAX CREDITS.*—*The amount of*
 23 *any income, war, profits, or excess profit taxes paid*
 24 *(or deemed paid under sections 902 and 960) or ac-*
 25 *crued by the taxpayer with respect to the excess quali-*

1 *fied foreign distribution amount for which a credit*
 2 *would be allowable under section 901 in the absence*
 3 *of this section, shall be reduced by 85 percent. No de-*
 4 *duction shall be allowed under this chapter for the*
 5 *portion of any tax for which credit is not allowable*
 6 *by reason of the preceding sentence.*

7 “(4) *FOREIGN TAX CREDIT LIMITATION.—For*
 8 *purposes of section 904, there shall be disregarded 85*
 9 *percent of—*

10 “(A) *the excess qualified foreign distribution*
 11 *amount,*

12 “(B) *the amount determined under section*
 13 *78 which is attributable to such excess qualified*
 14 *foreign distribution amount, and*

15 “(C) *the amounts (including assets, gross*
 16 *income, and other relevant bases of apportion-*
 17 *ment) which are attributable to the excess quali-*
 18 *fied foreign distribution amount which would,*
 19 *determined without regard to this section, be*
 20 *used to apportion the expenses, losses, and deduc-*
 21 *tions of the taxpayer under section 861 and 864*
 22 *in determining its taxable income from sources*
 23 *without the United States.*

24 *For purposes of applying subparagraph (C), the prin-*
 25 *ciples of section 864(e)(3)(A) shall apply.*

1 “(5) *TREATMENT OF ACQUISITIONS AND DISPOSI-*
 2 *TIONS.—Rules similar to the rules of section 41(f)(3)*
 3 *shall apply in the case of acquisitions or dispositions*
 4 *of controlled foreign corporations occurring on or*
 5 *after the first day of the earliest taxable year taken*
 6 *into account in determining the fixed base period.*

7 “(6) *TREATMENT OF CONSOLIDATED GROUPS.—*
 8 *Members of an affiliated group of corporations filing*
 9 *a consolidated return under section 1501 shall be*
 10 *treated as a single taxpayer for purposes of this sec-*
 11 *tion.*

12 “(7) *DESIGNATION OF DIVIDENDS.—Subject to*
 13 *subsection (b)(2), the taxpayer shall designate the*
 14 *particular dividends received during the taxable year*
 15 *from 1 or more corporations which are controlled for-*
 16 *foreign corporations in which it is a United States*
 17 *shareholder which are dividends excluded from the ex-*
 18 *cess qualified foreign distribution amount. The total*
 19 *amount of such designated dividends shall equal the*
 20 *base dividend amount.*

21 “(8) *TREATMENT OF EXPENSES, LOSSES, AND*
 22 *DEDUCTIONS.—Any expenses, losses, or deductions of*
 23 *the taxpayer allowable under subchapter B—*

24 “(A) *shall not be applied to reduce the*
 25 *amounts described in subsection (a)(1), and*

1 “(B) shall be applied to reduce other income
2 of the taxpayer (determined without regard to
3 the amounts described in subsection (a)(1)).

4 “(d) ELECTION.—

5 “(1) IN GENERAL.—An election under this sec-
6 tion shall be made on the taxpayer’s timely filed in-
7 come tax return for the first taxable year (determined
8 by taking extensions into account) ending 120 days or
9 more after the date of the enactment of this section,
10 and, once made, may be revoked only with the consent
11 of the Secretary.

12 “(2) ALL CONTROLLED FOREIGN CORPORA-
13 TIONS.—The election shall apply to all corporations
14 which are controlled foreign corporations in which the
15 taxpayer is a United States shareholder during the
16 taxable year.

17 “(3) CONSOLIDATED GROUPS.—If a taxpayer is
18 a member of an affiliated group of corporations filing
19 a consolidated return under section 1501 for the tax-
20 able year, an election under this section shall be made
21 by the common parent of the affiliated group which
22 includes the taxpayer and shall apply to all members
23 of the affiliated group.

24 “(e) REGULATIONS.—The Secretary shall prescribe
25 such regulations as may be necessary and appropriate to

1 carry out the purposes of this section, including regulations
 2 under section 55 and regulations addressing corporations
 3 which, during the fixed base period or thereafter, join or
 4 leave an affiliated group of corporations filing a consoli-
 5 dated return.”.

6 (b) CONFORMING AMENDMENT.—The table of sections
 7 for subpart F of part III of subchapter N of chapter 1 is
 8 amended by adding at the end the following new item:

“Sec. 965. Toll tax imposed on excess qualified foreign distribution
 amount.”.

9 (c) EFFECTIVE DATE.—The amendments made by this
 10 section shall apply only to the first taxable year of the elect-
 11 ing taxpayer ending 120 days or more after the date of the
 12 enactment of this Act.

13 **SEC. 232. EXCLUSION OF INCOME DERIVED FROM CERTAIN**
 14 **WAGERS ON HORSE RACES AND DOG RACES**
 15 **FROM GROSS INCOME OF NONRESIDENT**
 16 **ALIEN INDIVIDUALS.**

17 (a) IN GENERAL.—Subsection (b) of section 872 (relat-
 18 ing to exclusions) is amended by redesignating paragraphs
 19 (5), (6), and (7) as paragraphs (6), (7), and (8), respec-
 20 tively, and inserting after paragraph (4) the following new
 21 paragraph:

22 “(5) INCOME DERIVED FROM WAGERING TRANS-
 23 ACTIONS IN CERTAIN PARIMUTUEL POOLS.—Gross in-
 24 come derived by a nonresident alien individual from

1 *a legal wagering transaction initiated outside the*
2 *United States in a parimutuel pool with respect to a*
3 *live horse race or dog race in the United States.”.*

4 (b) *CONFORMING AMENDMENT.*—Section 883(a)(4) is
5 amended by striking “(5), (6), and (7)” and inserting “(6),
6 (7), and (8)”.

7 (c) *EFFECTIVE DATE.*—*The amendments made by this*
8 *section shall apply to wagers made after the date of the en-*
9 *actment of this Act.*

10 SEC. 233. LIMITATION OF WITHHOLDING TAX FOR PUERTO
11 RICO CORPORATIONS.

12 (a) *IN GENERAL*.—Subsection (b) of section 881 is
13 amended by redesignating paragraph (2) as paragraph (3)
14 and by inserting after paragraph (1) the following new
15 paragraph:

16 “(2) COMMONWEALTH OF PUERTO RICO.—If
17 *dividends are received during a taxable year by a cor-*
18 *poration—*

19 “(A) created or organized in, or under the
20 law of, the Commonwealth of Puerto Rico, and

21 “(B) with respect to which the requirements
22 of subparagraphs (A), (B), and (C) of paragraph
23 (1) are met for the taxable year,
24 subsection (a) shall be applied for such taxable year
25 by substituting ‘10 percent’ for ‘30 percent’.”.

1 (b) *WITHHOLDING*.—Subsection (c) of section 1442
 2 *(relating to withholding of tax on foreign corporations)* is
 3 amended—

4 (1) by striking “For purposes” and inserting the
 5 following:

6 “(1) GUAM, AMERICAN SAMOA, THE NORTHERN
 7 MARIANA ISLANDS, AND THE VIRGIN ISLANDS.—For
 8 purposes”, and

9 (2) by adding at the end the following new para-
 10 graph:

11 “(2) COMMONWEALTH OF PUERTO RICO.—If
 12 dividends are received during a taxable year by a cor-
 13 poration—

14 “(A) created or organized in, or under the
 15 law of, the Commonwealth of Puerto Rico, and

16 “(B) with respect to which the requirements
 17 of subparagraphs (A), (B), and (C) of section
 18 881(b)(1) are met for the taxable year,

19 subsection (a) shall be applied for such taxable year
 20 by substituting ‘10 percent’ for ‘30 percent’.”.

21 (b) *CONFORMING AMENDMENTS*.—

22 (1) Subsection (b) of section 881 is amended by
 23 striking “GUAM AND VIRGIN ISLANDS CORPORA-
 24 TIONS” in the heading and inserting “POSSESSIONS”.

1 (2) Paragraph (1) of section 881(b) is amended
 2 by striking "IN GENERAL" in the heading and insert-
 3 ing "GUAM, AMERICAN SAMOA, THE NORTHERN MAR-
 4 IANA ISLANDS, AND THE VIRGIN ISLANDS".

5 (c) *EFFECTIVE DATE.*—The amendments made by this
 6 section shall apply to dividends paid after the date of the
 7 enactment of this Act.

8 **SEC. 234. REPORT ON WTO DISPUTE SETTLEMENT PANELS**
 9 **AND THE APPELLATE BODY.**

10 Not later than March 31, 2004, the Secretary of Com-
 11 merce, in consultation with the United States Trade Rep-
 12 resentative, shall transmit a report to the Committee on Fi-
 13 nance of the Senate and the Committee on Ways and Means
 14 of the House of Representatives, regarding whether dispute
 15 settlement panels and the Appellate Body of the World
 16 Trade Organization have—

17 (1) added to or diminished the rights of the
 18 United States by imposing obligations or restrictions
 19 on the use of antidumping, countervailing, and safe-
 20 guard measures not agreed to under the Agreement on
 21 Implementation of Article VI of the General Agree-
 22 ment on Tariffs and Trade of 1994, the Agreement on
 23 Subsidies and Countervailing Measures, and the
 24 Agreement on Safeguards;

1 (2) appropriately applied the standard of review
 2 contained in Article 17.6 of the Agreement on Imple-
 3 mentation of Article VI of the General Agreement on
 4 Tariffs and Trade of 1994; or

5 (3) exceeded their authority or terms of reference
 6 under the Agreements referred to in paragraph (1).

7 **SEC. 235. STUDY OF IMPACT OF INTERNATIONAL TAX LAWS**
 8 **ON TAXPAYERS OTHER THAN LARGE COR-**
 9 **PORATIONS.**

10 (a) *STUDY.*—The Secretary of the Treasury or the Sec-
 11 retary's delegate shall conduct a study of the impact of Fed-
 12 eral international tax rules on taxpayers other than large
 13 corporations, including the burdens placed on such tax-
 14 payers in complying with such rules.

15 (b) *REPORT.*—Not later than 180 days after the date
 16 of the enactment of this Act, the Secretary shall report to
 17 the Committee on Finance of the Senate and the Committee
 18 on Ways and Means of the House of Representatives the
 19 results of the study conducted under subsection (a), includ-
 20 ing any recommendations for legislative or administrative
 21 changes to reduce the compliance burden on taxpayers other
 22 than large corporations and for such other purposes as the
 23 Secretary determines appropriate.

1 **SEC. 236. CONSULTATIVE ROLE FOR SENATE COMMITTEE**
2 **ON FINANCE IN CONNECTION WITH THE RE-**
3 **VIEW OF PROPOSED TAX TREATIES.**

4 *Paragraph 1(j) of Rule XXV of the Standing Rules of*
5 *the Senate is amended by adding at the end the following:*

6 *“(3)(A) Notwithstanding any other rule of the Senate,*
7 *the Committee on Foreign Relations shall consult with the*
8 *Committee on Finance with respect to any proposed treaty*
9 *on taxation prior to reporting such treaty to the Senate.*

10 *“(B) The Committee on Foreign Relations shall request*
11 *in writing the views of the Committee on Finance with re-*
12 *spect to any proposed treaty on taxation which is referred*
13 *to the Committee on Foreign Relations. Not less than 120*
14 *days after the date on which such request is made, the Com-*
15 *mittee on Finance shall respond to such request in writing.*
16 *If the Committee on Finance does not provide such written*
17 *response during such 120 day period, the Committee on Fi-*
18 *nance shall be deemed to have waived the opportunity to*
19 *submit such views.*

20 *“(C) The Committee on Foreign Relations shall con-*
21 *sider the views submitted by the Committee on Finance and*
22 *shall include such views in any report of the treaty to the*
23 *Senate.”.*

1 **TITLE III—DOMESTIC MANUFAC-**
 2 **TURING AND BUSINESS PRO-**
 3 **VISIONS**

4 **Subtitle A—General Provisions**

5 **SEC. 301. EXPANSION OF QUALIFIED SMALL-ISSUE BOND**
 6 **PROGRAM.**

7 (a) *IN GENERAL.*—Subparagraph (F) of section
 8 144(a)(4) (relating to \$10,000,000 limit in certain cases)
 9 is amended to read as follows:

10 “(F) *ADDITIONAL CAPITAL EXPENDITURES*
 11 *NOT TAKEN INTO ACCOUNT.*—With respect to any
 12 issue, in addition to any capital expenditure de-
 13 scribed in subparagraph (C), capital expendi-
 14 tures of not to exceed \$10,000,000 shall not be
 15 taken into account for purposes of applying sub-
 16 paragraph (A)(ii).”

17 (b) *EFFECTIVE DATE.*—The amendment made by this
 18 section shall apply to bonds issued after the date of the en-
 19 actment of this Act.

20 **SEC. 302. EXPENSING OF BROADBAND INTERNET ACCESS**
 21 **EXPENDITURES.**

22 (a) *IN GENERAL.*—Part VI of subchapter B of chapter
 23 1 (relating to itemized deductions for individuals and cor-
 24 porations) is amended by inserting after section 190 the fol-
 25 lowing new section:

1 **"SEC. 191. BROADBAND EXPENDITURES.**

2 **"(a) TREATMENT OF EXPENDITURES.—**

3 **"(1) IN GENERAL.—**A taxpayer may elect to
4 treat any qualified broadband expenditure which is
5 paid or incurred by the taxpayer as an expense which
6 is not chargeable to capital account. Any expenditure
7 which is so treated shall be allowed as a deduction.

8 **"(2) ELECTION.—**An election under paragraph
9 (1) shall be made at such time and in such manner
10 as the Secretary may prescribe by regulation.

11 **"(b) QUALIFIED BROADBAND EXPENDITURES.—**For
12 purposes of this section—

13 **"(1) IN GENERAL.—**The term 'qualified
14 broadband expenditure' means, with respect to any
15 taxable year, any direct or indirect costs incurred
16 during 2004 and properly taken into account for such
17 taxable year with respect to—

18 **"(A)** the purchase or installation of quali-
19 fied equipment (including any upgrades thereto),
20 and

21 **"(B)** the connection of such qualified equip-
22 ment to any qualified subscriber.

23 **"(2) CERTAIN SATELLITE EXPENDITURES EX-**
24 **CLUDED.—**Such term shall not include any costs in-
25 curred with respect to the launching of any satellite
26 equipment.

1 “(3) *LEASED EQUIPMENT*.—Such term shall in-
 2 clude so much of the purchase price paid by the lessor
 3 of qualified equipment subject to a lease described in
 4 subsection (c)(2)(B) as is attributable to expenditures
 5 incurred by the lessee which would otherwise be de-
 6 scribed in paragraph (1).

7 “(c) *WHEN EXPENDITURES TAKEN INTO ACCOUNT*.—
 8 For purposes of this section—

9 “(1) *IN GENERAL*.—Qualified broadband expend-
 10 itures with respect to qualified equipment shall be
 11 taken into account with respect to the first taxable
 12 year in which—

13 “(A) current generation broadband services
 14 are provided through such equipment to qualified
 15 subscribers, or

16 “(B) next generation broadband services are
 17 provided through such equipment to qualified
 18 subscribers.

19 “(2) *LIMITATION*.—

20 “(A) *IN GENERAL*.—Qualified expenditures
 21 shall be taken into account under paragraph (1)
 22 only with respect to qualified equipment—

23 “(i) the original use of which com-
 24 mences with the taxpayer, and

1 “(ii) which is placed in service, after
2 December 31, 2003.

3 “(B) SALE-LEASEBACKS.—For purposes of
4 subparagraph (A), if property—

5 “(i) is originally placed in service
6 after December 31, 2003, by any person,
7 and

8 “(ii) sold and leased back by such per-
9 son within 3 months after the date such
10 property was originally placed in service,
11 such property shall be treated as originally
12 placed in service not earlier than the date on
13 which such property is used under the leaseback
14 referred to in clause (ii).

15 “(d) SPECIAL ALLOCATION RULES.—

16 “(1) CURRENT GENERATION BROADBAND SERV-
17 ICES.—For purposes of determining the amount of
18 qualified broadband expenditures under subsection
19 (a)(1) with respect to qualified equipment through
20 which current generation broadband services are pro-
21 vided, if the qualified equipment is capable of serving
22 both qualified subscribers and other subscribers, the
23 qualified broadband expenditures shall be multiplied
24 by a fraction—

1 “(A) the numerator of which is the sum of
2 the number of potential qualified subscribers
3 within the rural areas and the underserved areas
4 which the equipment is capable of serving with
5 current generation broadband services, and

6 “(B) the denominator of which is the total
7 potential subscriber population of the area which
8 the equipment is capable of serving with current
9 generation broadband services.

10 “(2) NEXT GENERATION BROADBAND SERV-
11 ICES.—For purposes of determining the amount of
12 qualified broadband expenditures under subsection
13 (a)(1) with respect to qualified equipment through
14 which next generation broadband services are pro-
15 vided, if the qualified equipment is capable of serving
16 both qualified subscribers and other subscribers, the
17 qualified expenditures shall be multiplied by a frac-
18 tion—

19 “(A) the numerator of which is the sum
20 of—

21 “(i) the number of potential qualified
22 subscribers within the rural areas and un-
23 derserved areas, plus

24 “(ii) the number of potential qualified
25 subscribers within the area consisting only

1 *of residential subscribers not described in*
 2 *clause (i),*
 3 *which the equipment is capable of serving with*
 4 *next generation broadband services, and*

5 *“(B) the denominator of which is the total*
 6 *potential subscriber population of the area which*
 7 *the equipment is capable of serving with next*
 8 *generation broadband services.*

9 *“(e) DEFINITIONS.—For purposes of this section—*

10 *“(1) ANTENNA.—The term ‘antenna’ means any*
 11 *device used to transmit or receive signals through the*
 12 *electromagnetic spectrum, including satellite equip-*
 13 *ment.*

14 *“(2) CABLE OPERATOR.—The term ‘cable oper-*
 15 *ator’ has the meaning given such term by section*
 16 *602(5) of the Communications Act of 1934 (47 U.S.C.*
 17 *522(5)).*

18 *“(3) COMMERCIAL MOBILE SERVICE CARRIER.—*
 19 *The term ‘commercial mobile service carrier’ means*
 20 *any person authorized to provide commercial mobile*
 21 *radio service as defined in section 20.3 of title 47,*
 22 *Code of Federal Regulations.*

23 *“(4) CURRENT GENERATION BROADBAND SERV-*
 24 *ICE.—The term ‘current generation broadband serv-*
 25 *ice’ means the transmission of signals at a rate of at*

1 *least 1,000,000 bits per second to the subscriber and*
2 *at least 128,000 bits per second from the subscriber.*

3 “(5) *MULTIPLEXING OR DEMULTIPLEXING.*—*The*
4 *term ‘multiplexing’ means the transmission of 2 or*
5 *more signals over a single channel, and the term*
6 *‘demultiplexing’ means the separation of 2 or more*
7 *signals previously combined by compatible multi-*
8 *plexing equipment.*

9 “(6) *NEXT GENERATION BROADBAND SERVICE.*—
10 *The term ‘next generation broadband service’ means*
11 *the transmission of signals at a rate of at least*
12 *22,000,000 bits per second to the subscriber and at*
13 *least 5,000,000 bits per second from the subscriber.*

14 “(7) *NONRESIDENTIAL SUBSCRIBER.*—*The term*
15 *‘nonresidential subscriber’ means any person who*
16 *purchases broadband services which are delivered to*
17 *the permanent place of business of such person.*

18 “(8) *OPEN VIDEO SYSTEM OPERATOR.*—*The term*
19 *‘open video system operator’ means any person au-*
20 *thorized to provide service under section 653 of the*
21 *Communications Act of 1934 (47 U.S.C. 573).*

22 “(9) *OTHER WIRELESS CARRIER.*—*The term*
23 *‘other wireless carrier’ means any person (other than*
24 *a telecommunications carrier, commercial mobile*
25 *service carrier, cable operator, open video system op-*

1 erator, or satellite carrier) providing current genera-
 2 tion broadband services or next generation broadband
 3 service to subscribers through the radio transmission
 4 of energy.

5 “(10) *PACKET SWITCHING*.—The term ‘packet
 6 switching’ means controlling or routing the path of
 7 any digitized transmission signal which is assembled
 8 into packets or cells.

9 “(11) *PROVIDER*.—The term ‘provider’ means,
 10 with respect to any qualified equipment—

11 “(A) a cable operator,

12 “(B) a commercial mobile service carrier,

13 “(C) an open video system operator,

14 “(D) a satellite carrier,

15 “(E) a telecommunications carrier, or

16 “(F) any other wireless carrier,

17 providing current generation broadband services or
 18 next generation broadband services to subscribers
 19 through such qualified equipment.

20 “(12) *PROVISION OF SERVICES*.—A provider
 21 shall be treated as providing services to 1 or more
 22 subscribers if—

23 “(A) such a subscriber has been passed by
 24 the provider’s equipment and can be connected to
 25 such equipment for a standard connection fee,

1 “(B) the provider is physically able to de-
 2 liver current generation broadband services or
 3 next generation broadband services, as applica-
 4 ble, to such a subscriber without making more
 5 than an insignificant investment with respect to
 6 such subscriber,

7 “(C) the provider has made reasonable ef-
 8 forts to make such subscribers aware of the avail-
 9 ability of such services,

10 “(D) such services have been purchased by
 11 1 or more such subscribers, and

12 “(E) such services are made available to
 13 such subscribers at average prices comparable to
 14 those at which the provider makes available
 15 similar services in any areas in which the pro-
 16 vider makes available such services.

17 “(13) QUALIFIED EQUIPMENT.—

18 “(A) IN GENERAL.—The term ‘qualified
 19 equipment’ means equipment which provides
 20 current generation broadband services or next
 21 generation broadband services—

22 “(i) at least a majority of the time
 23 during periods of maximum demand to
 24 each subscriber who is utilizing such serv-
 25 ices, and

1 “(ii) in a manner substantially the
2 same as such services are provided by the
3 provider to subscribers through equipment
4 with respect to which no deduction is al-
5 lowed under subsection (a)(1).

6 “(B) ONLY CERTAIN INVESTMENT TAKEN
7 INTO ACCOUNT.—Except as provided in subpara-
8 graph (C) or (D), equipment shall be taken into
9 account under subparagraph (A) only to the ex-
10 tent it—

11 “(i) extends from the last point of
12 switching to the outside of the unit, build-
13 ing, dwelling, or office owned or leased by
14 a subscriber in the case of a telecommuni-
15 cations carrier,

16 “(ii) extends from the customer side of
17 the mobile telephone switching office to a
18 transmission/receive antenna (including
19 such antenna) owned or leased by a sub-
20 scriber in the case of a commercial mobile
21 service carrier,

22 “(iii) extends from the customer side of
23 the headend to the outside of the unit, build-
24 ing, dwelling, or office owned or leased by

1 a subscriber in the case of a cable operator
2 or open video system operator, or

3 “(iv) extends from a transmission/re-
4 ceive antenna (including such antenna)
5 which transmits and receives signals to or
6 from multiple subscribers, to a trans-
7 mission/receive antenna (including such an-
8 tenna) on the outside of the unit, building,
9 dwelling, or office owned or leased by a sub-
10 scriber in the case of a satellite carrier or
11 other wireless carrier, unless such other
12 wireless carrier is also a telecommuni-
13 cations carrier.

14 “(C) *PACKET SWITCHING EQUIPMENT.*—

15 *Packet switching equipment, regardless of loca-*
16 *tion, shall be taken into account under subpara-*
17 *graph (A) only if it is deployed in connection*
18 *with equipment described in subparagraph (B)*
19 *and is uniquely designed to perform the function*
20 *of packet switching for current generation*
21 *broadband services or next generation broadband*
22 *services, but only if such packet switching is the*
23 *last in a series of such functions performed in*
24 *the transmission of a signal to a subscriber or*
25 *the first in a series of such functions performed*

1 *in the transmission of a signal from a sub-*
 2 *scriber.*

3 *“(D) MULTIPLEXING AND DEMULTIPLEXING*
 4 *EQUIPMENT.—Multiplexing and demultiplexing*
 5 *equipment shall be taken into account under sub-*
 6 *paragraph (A) only to the extent it is deployed*
 7 *in connection with equipment described in sub-*
 8 *paragraph (B) and is uniquely designed to per-*
 9 *form the function of multiplexing and*
 10 *demultiplexing packets or cells of data and mak-*
 11 *ing associated application adaptations, but only if*
 12 *such multiplexing or demultiplexing equipment*
 13 *is located between packet switching equipment*
 14 *described in subparagraph (C) and the sub-*
 15 *scriber’s premises.*

16 *“(14) QUALIFIED SUBSCRIBER.—The term*
 17 *‘qualified subscriber’ means—*

18 *“(A) with respect to the provision of current*
 19 *generation broadband services—*

20 *“(i) any nonresidential subscriber*
 21 *maintaining a permanent place of business*
 22 *in a rural area or underserved area, or*

23 *“(ii) any residential subscriber resid-*
 24 *ing in a dwelling located in a rural area or*

1 underserved area which is not a saturated
2 market, and

3 “(B) with respect to the provision of next
4 generation broadband services—

5 “(i) any nonresidential subscriber
6 maintaining a permanent place of business
7 in a rural area or underserved area, or

8 “(ii) any residential subscriber.

9 “(15) RESIDENTIAL SUBSCRIBER.—The term
10 ‘residential subscriber’ means any individual who
11 purchases broadband services which are delivered to
12 such individual’s dwelling.

13 “(16) RURAL AREA.—The term ‘rural area’
14 means any census tract which—

15 “(A) is not within 10 miles of any incor-
16 porated or census designated place containing
17 more than 25,000 people, and

18 “(B) is not within a county or county
19 equivalent which has an overall population den-
20 sity of more than 500 people per square mile of
21 land.

22 “(17) RURAL SUBSCRIBER.—The term ‘rural
23 subscriber’ means any residential subscriber residing
24 in a dwelling located in a rural area or nonresiden-

1 *tial subscriber maintaining a permanent place of*
 2 *business located in a rural area.*

3 *“(18) SATELLITE CARRIER.—The term ‘satellite*
 4 *carrier’ means any person using the facilities of a*
 5 *satellite or satellite service licensed by the Federal*
 6 *Communications Commission and operating in the*
 7 *Fixed-Satellite Service under part 25 of title 47 of the*
 8 *Code of Federal Regulations or the Direct Broadcast*
 9 *Satellite Service under part 100 of title 47 of such*
 10 *Code to establish and operate a channel of commu-*
 11 *nications for distribution of signals, and owning or*
 12 *leasing a capacity or service on a satellite in order*
 13 *to provide such point-to-multipoint distribution.*

14 *“(19) SATURATED MARKET.—The term ‘satu-*
 15 *rated market’ means any census tract in which, as of*
 16 *the date of the enactment of this section—*

17 *“(A) current generation broadband services*
 18 *have been provided by a single provider to 85*
 19 *percent or more of the total number of potential*
 20 *residential subscribers residing in dwellings lo-*
 21 *cated within such census tract, and*

22 *“(B) such services can be utilized—*

23 *“(i) at least a majority of the time*
 24 *during periods of maximum demand by*

1 each such subscriber who is utilizing such
2 services, and

3 “(ii) in a manner substantially the
4 same as such services are provided by the
5 provider to subscribers through equipment
6 with respect to which no deduction is al-
7 lowed under subsection (a)(1).

8 “(20) *SUBSCRIBER.*—The term ‘subscriber’
9 means any person who purchases current generation
10 broadband services or next generation broadband serv-
11 ices.

12 “(21) *TELECOMMUNICATIONS CARRIER.*—The
13 term ‘telecommunications carrier’ has the meaning
14 given such term by section 3(44) of the Communica-
15 tions Act of 1934 (47 U.S.C. 153(44)), but—

16 “(A) includes all members of an affiliated
17 group of which a telecommunications carrier is
18 a member, and

19 “(B) does not include a commercial mobile
20 service carrier.

21 “(22) *TOTAL POTENTIAL SUBSCRIBER POPU-*
22 *LATION.*—The term ‘total potential subscriber popu-

23 lation’ means, with respect to any area and based on
24 the most recent census data, the total number of po-
25 tential residential subscribers residing in dwellings

1 *located in such area and potential nonresidential sub-*
 2 *scribers maintaining permanent places of business lo-*
 3 *cated in such area.*

4 *“(23) UNDERSERVED AREA.—The term ‘under-*
 5 *served area’ means—*

6 *“(A) any census tract which is located in—*

7 *“(i) an empowerment zone or enter-*
 8 *prise community designated under section*
 9 *1391, or*

10 *“(ii) the District of Columbia Enter-*
 11 *prise Zone established under section 1400,*
 12 *or*

13 *“(B) any census tract—*

14 *“(i) the poverty level of which is at*
 15 *least 30 percent (based on the most recent*
 16 *census data), and*

17 *“(ii) the median family income of*
 18 *which does not exceed—*

19 *“(I) in the case of a census tract*
 20 *located in a metropolitan statistical*
 21 *area, 70 percent of the greater of the*
 22 *metropolitan area median family in-*
 23 *come or the statewide median family*
 24 *income, and*

1 “(II) in the case of a census tract
 2 located in a nonmetropolitan statis-
 3 tical area, 70 percent of the nonmetro-
 4 politan statewide median family in-
 5 come.

6 “(24) *UNDERSERVED SUBSCRIBER.*—The term
 7 ‘underserved subscriber’ means any residential sub-
 8 scriber residing in a dwelling located in an under-
 9 served area or nonresidential subscriber maintaining
 10 a permanent place of business located in an under-
 11 served area.

12 “(f) *SPECIAL RULES.*—

13 “(1) *PROPERTY USED OUTSIDE THE UNITED*
 14 *STATES, ETC., NOT QUALIFIED.*—No expenditures
 15 shall be taken into account under subsection (a)(1)
 16 with respect to the portion of the cost of any property
 17 referred to in section 50(b) or with respect to the por-
 18 tion of the cost of any property specified in an elec-
 19 tion under section 179.

20 “(2) *BASIS REDUCTION.*—

21 “(A) *IN GENERAL.*—For purposes of this
 22 title, the basis of any property shall be reduced
 23 by the portion of the cost of such property taken
 24 into account under subsection (a)(1).

1 “(B) *ORDINARY INCOME RECAPTURE.*—For
 2 purposes of section 1245, the amount of the de-
 3 duction allowable under subsection (a)(1) with
 4 respect to any property which is of a character
 5 subject to the allowance for depreciation shall be
 6 treated as a deduction allowed for depreciation
 7 under section 167.

8 “(3) *COORDINATION WITH SECTION 38.*—No cred-
 9 it shall be allowed under section 38 with respect to
 10 any amount for which a deduction is allowed under
 11 subsection (a)(1).”.

12 (b) *SPECIAL RULE FOR MUTUAL OR COOPERATIVE*
 13 *TELEPHONE COMPANIES.*—Section 501(c)(12)(B) (relating
 14 to list of exempt organizations) is amended by striking “or”
 15 at the end of clause (iii), by striking the period at the end
 16 of clause (iv) and inserting “, or”, and by adding at the
 17 end the following:

18 “(v) from the sale of property subject to
 19 a lease described in section 191(c)(2)(B),
 20 but only to the extent such income does not
 21 in any year exceed an amount equal to the
 22 qualified broadband expenditures which
 23 would be taken into account under section
 24 191 for such year if the mutual or coopera-
 25 tive telephone company was not exempt

1 *from taxation and was treated as the owner*
 2 *of the property subject to such lease.”.*

3 (c) *CONFORMING AMENDMENTS.—*

4 (1) *Section 263(a)(1) (relating to capital ex-*
 5 *penditures) is amended by striking “or” at the end of*
 6 *subparagraph (G), by striking the period at the end*
 7 *of subparagraph (H) and inserting “, or”, and by*
 8 *adding at the end the following new subparagraph:*

9 *“(I) expenditures for which a deduction is*
 10 *allowed under section 191.”.*

11 (2) *Section 1016(a) of such Code is amended by*
 12 *striking “and” at the end of paragraph (27), by strik-*
 13 *ing the period at the end of paragraph (28) and in-*
 14 *serting “, and”, and by adding at the end the fol-*
 15 *lowing new paragraph:*

16 *“(29) to the extent provided in section*
 17 *191(f)(2).”.*

18 (3) *The table of sections for part VI of sub-*
 19 *chapter A of chapter 1 of such Code is amended by*
 20 *inserting after the item relating to section 190 the fol-*
 21 *lowing new item:*

“Sec. 191. Broadband expenditures.”.

22 (d) *DESIGNATION OF CENSUS TRACTS.—*

23 (1) *IN GENERAL.—The Secretary of the Treasury*
 24 *shall, not later than 90 days after the date of the en-*
 25 *actment of this Act, designate and publish those cen-*

1 *sus tracts meeting the criteria described in para-*
 2 *graphs (16), (22), and (23) of section 191(e) of the In-*
 3 *ternal Revenue Code of 1986 (as added by this sec-*
 4 *tion). In making such designations, the Secretary of*
 5 *the Treasury shall consult with such other depart-*
 6 *ments and agencies as the Secretary determines ap-*
 7 *propriate.*

8 (2) *SATURATED MARKET.—*

9 (A) *IN GENERAL.—For purposes of desig-*
 10 *nating and publishing those census tracts meet-*
 11 *ing the criteria described in subsection (e)(19) of*
 12 *such section 191—*

13 (i) *the Secretary of the Treasury shall*
 14 *prescribe not later than 30 days after the*
 15 *date of the enactment of this Act the form*
 16 *upon which any provider which takes the*
 17 *position that it meets such criteria with re-*
 18 *spect to any census tract shall submit a list*
 19 *of such census tracts (and any other infor-*
 20 *mation required by the Secretary) not later*
 21 *than 60 days after the date of the publica-*
 22 *tion of such form, and*

23 (ii) *the Secretary of the Treasury shall*
 24 *publish an aggregate list of such census*
 25 *tracts and the applicable providers not later*

1 than 30 days after the last date such sub-
2 missions are allowed under clause (i).

3 (B) NO SUBSEQUENT LISTS REQUIRED.—

4 The Secretary of the Treasury shall not be re-
5 quired to publish any list of census tracts meet-
6 ing such criteria subsequent to the list described
7 in subparagraph (A)(ii).

8 (e) OTHER REGULATORY MATTERS.—

9 (1) PROHIBITION.—No Federal or State agency
10 or instrumentality shall adopt regulations or rate-
11 making procedures that would have the effect of elimi-
12 nating or reducing any deduction or portion thereof
13 allowed under section 191 of the Internal Revenue
14 Code of 1986 (as added by this section) or otherwise
15 subverting the purpose of this section.

16 (2) TREASURY REGULATORY AUTHORITY.—It is
17 the intent of Congress in providing the election to de-
18 duct qualified broadband expenditures under section
19 191 of the Internal Revenue Code of 1986 (as added
20 by this section) to provide incentives for the purchase,
21 installation, and connection of equipment and facili-
22 ties offering expanded broadband access to the Inter-
23 net for users in certain low income and rural areas
24 of the United States, as well as to residential users
25 nationwide, in a manner that maintains competitive

1 *neutrality among the various classes of providers of*
 2 *broadband services. Accordingly, the Secretary of the*
 3 *Treasury shall prescribe such regulations as may be*
 4 *necessary or appropriate to carry out the purposes of*
 5 *section 191 of such Code, including—*

6 *(A) regulations to determine how and when*
 7 *a taxpayer that incurs qualified broadband ex-*
 8 *penditures satisfies the requirements of section*
 9 *191 of such Code to provide broadband services,*
 10 *and*

11 *(B) regulations describing the information,*
 12 *records, and data taxpayers are required to pro-*
 13 *vide the Secretary to substantiate compliance*
 14 *with the requirements of section 191 of such*
 15 *Code.*

16 *(f) EFFECTIVE DATE.—The amendments made by this*
 17 *section shall apply to expenditures incurred after December*
 18 *31, 2003.*

19 **SEC. 303. EXEMPTION OF NATURAL AGING PROCESS IN DE-**
 20 **TERMINATION OF PRODUCTION PERIOD FOR**
 21 **DISTILLED SPIRITS UNDER SECTION 263A.**

22 *(a) IN GENERAL.—Section 263A(f) of the Internal*
 23 *Revenue Code of 1986 (relating to general exceptions) is*
 24 *amended by adding at the end the following new paragraph:*

1 “(5) *EXEMPTION OF NATURAL AGING PROCESS IN*
 2 *DETERMINATION OF PRODUCTION PERIOD FOR DIS-*
 3 *TILLED SPIRITS.*—*For purposes of this subsection, the*
 4 *production period for distilled spirits shall be deter-*
 5 *mined without regard to any period allocated to the*
 6 *natural aging process.”.*

7 (b) *EFFECTIVE DATE.*—*The amendment made by this*
 8 *section shall apply to production periods beginning after*
 9 *the date of the enactment of this Act.*

10 **SEC. 304. MODIFICATION OF ACTIVE BUSINESS DEFINITION**
 11 **UNDER SECTION 355.**

12 (a) *IN GENERAL.*—*Section 355(b) (defining active con-*
 13 *duct of a trade or business) is amended by adding at the*
 14 *end the following new paragraph:*

15 “(3) *SPECIAL RULES RELATING TO ACTIVE BUSI-*
 16 *NESS REQUIREMENT.*—

17 “(A) *IN GENERAL.*—*For purposes of deter-*
 18 *mining whether a corporation meets the require-*
 19 *ment of paragraph (2)(A), all members of such*
 20 *corporation’s separate affiliated group shall be*
 21 *treated as one corporation. For purposes of the*
 22 *preceding sentence, a corporation’s separate af-*
 23 *filiated group is the affiliated group which would*
 24 *be determined under section 1504(a) if such cor-*

1 *poration were the common parent and section*
 2 *1504(b) did not apply.*

3 *“(B) CONTROL.—For purposes of para-*
 4 *graph (2)(D), all distributee corporations which*
 5 *are members of the same affiliated group (as de-*
 6 *finied in section 1504(a) without regard to sec-*
 7 *tion 1504(b)) shall be treated as one distributee*
 8 *corporation.”.*

9 *(b) CONFORMING AMENDMENTS.—*

10 *(1) Subparagraph (A) of section 355(b)(2) is*
 11 *amended to read as follows:*

12 *“(A) it is engaged in the active conduct of*
 13 *a trade or business,”.*

14 *(2) Section 355(b)(2) is amended by striking the*
 15 *last sentence.*

16 *(c) EFFECTIVE DATE.—*

17 *(1) IN GENERAL.—The amendments made by*
 18 *this section shall apply—*

19 *(A) to distributions after the date of the en-*
 20 *actment of this Act, and*

21 *(B) for purposes of determining the contin-*
 22 *ued qualification under section 355(b)(2)(A) of*
 23 *the Internal Revenue Code of 1986 (as amended*
 24 *by subsection (b)(1)) of distributions made before*

1 such date, as a result of an acquisition, disposi-
 2 tion, or other restructuring after such date.

3 (2) *TRANSITION RULE.*—The amendments made
 4 by this section shall not apply to any distribution
 5 pursuant to a transaction which is—

6 (A) made pursuant to an agreement which
 7 was binding on such date of enactment and at
 8 all times thereafter,

9 (B) described in a ruling request submitted
 10 to the Internal Revenue Service on or before such
 11 date, or

12 (C) described on or before such date in a
 13 public announcement or in a filing with the Se-
 14 curities and Exchange Commission.

15 (3) *ELECTION TO HAVE AMENDMENTS APPLY.*—
 16 Paragraph (2) shall not apply if the distributing cor-
 17 poration elects not to have such paragraph apply to
 18 distributions of such corporation. Any such election,
 19 once made, shall be irrevocable.

20 **SEC. 305. EXCLUSION OF CERTAIN INDEBTEDNESS OF**
 21 **SMALL BUSINESS INVESTMENT COMPANIES**
 22 **FROM ACQUISITION INDEBTEDNESS.**

23 (a) *IN GENERAL.*—Section 514(c) (relating to acquisi-
 24 tion indebtedness) is amended by adding at the end the fol-
 25 lowing new paragraph:

1 “(10) *CERTAIN INDEBTEDNESS OF SMALL BUSI-*
 2 *NESS INVESTMENT COMPANIES.*—For purposes of this
 3 section, the term ‘acquisition indebtedness’ does not
 4 include any indebtedness incurred by a small business
 5 investment company licensed under the Small Busi-
 6 ness Investment Act of 1958 which is evidenced by a
 7 debenture—

8 “(A) issued by such company under section
 9 303(a) of such Act, and

10 “(B) held or guaranteed by the Small Busi-
 11 ness Administration.”.

12 (b) *EFFECTIVE DATE.*—The amendment made by this
 13 section shall apply to any indebtedness incurred after De-
 14 cember 31, 2003, by a small business investment company
 15 described in section 514(c)(10) of the Internal Revenue Code
 16 of 1986 (as added by this section) with respect to property
 17 acquired by such company after such date.

18 **SEC. 306. MODIFIED TAXATION OF IMPORTED ARCHERY**
 19 **PRODUCTS.**

20 (a) *BOWS.*—Paragraph (1) of section 4161(b) (relating
 21 to bows) is amended to read as follows:

22 “(1) *BOWS.*—

23 “(A) *IN GENERAL.*—There is hereby im-
 24 posed on the sale by the manufacturer, producer,
 25 or importer of any bow which has a peak draw

1 *weight of 30 pounds or more, a tax equal to 11*
 2 *percent of the price for which so sold.*

3 *“(B) ARCHERY EQUIPMENT.—There is here-*
 4 *by imposed on the sale by the manufacturer, pro-*
 5 *ducer, or importer—*

6 *“(i) of any part or accessory suitable*
 7 *for inclusion in or attachment to a bow de-*
 8 *scribed in subparagraph (A), and*

9 *“(ii) of any quiver or broadhead suit-*
 10 *able for use with an arrow described in*
 11 *paragraph (2),*

12 *a tax equal to 11 percent of the price for which*
 13 *so sold.”.*

14 *(b) ARROWS.—Subsection (b) of section 4161 (relating*
 15 *to bows and arrows, etc.) is amended by redesignating para-*
 16 *graph (3) as paragraph (4) and inserting after paragraph*
 17 *(2) the following:*

18 *“(3) ARROWS.—*

19 *“(A) IN GENERAL.—There is hereby im-*
 20 *posed on the sale by the manufacturer, producer,*
 21 *or importer of any arrow, a tax equal to 12 per-*
 22 *cent of the price for which so sold.*

23 *“(B) EXCEPTION.—In the case of any arrow*
 24 *of which the shaft or any other component has*

1 *been previously taxed under paragraph (1) or*
 2 *(2)—*

3 *“(i) section 6416(b)(3) shall not apply,*
 4 *and*

5 *“(ii) the tax imposed by subparagraph*
 6 *(A) shall be an amount equal to the excess*
 7 *(if any) of—*

8 *“(I) the amount of tax imposed by*
 9 *this paragraph (determined without re-*
 10 *gard to this subparagraph), over*

11 *“(II) the amount of tax paid with*
 12 *respect to the tax imposed under para-*
 13 *graph (1) or (2) on such shaft or com-*
 14 *ponent.*

15 *“(C) ARROW.—For purposes of this para-*
 16 *graph, the term ‘arrow’ means any shaft de-*
 17 *scribed in paragraph (2) to which additional*
 18 *components are attached.”.*

19 *(c) CONFORMING AMENDMENTS.—Section 4161(b)(2)*
 20 *is amended—*

21 *(1) by inserting “(other than broadheads)” after*
 22 *“point”, and*

23 *(2) by striking “ARROWS.—” in the heading and*
 24 *inserting “ARROW COMPONENTS.—”.*

1 (d) *EFFECTIVE DATE.*—*The amendments made by this*
 2 *section shall apply to articles sold by the manufacturer,*
 3 *producer, or importer after December 31, 2003.*

4 **SEC. 307. MODIFICATION TO COOPERATIVE MARKETING**
 5 **RULES TO INCLUDE VALUE ADDED PROC-**
 6 **ESSING INVOLVING ANIMALS.**

7 (a) *IN GENERAL.*—*Section 1388 (relating to defini-*
 8 *tions and special rules) is amended by adding at the end*
 9 *the following new subsection:*

10 “(k) *COOPERATIVE MARKETING INCLUDES VALUE-*
 11 *ADDED PROCESSING INVOLVING ANIMALS.*—*For purposes*
 12 *of section 521 and this subchapter, the marketing of the*
 13 *products of members or other producers shall include the*
 14 *feeding of such products to cattle, hogs, fish, chickens, or*
 15 *other animals and the sale of the resulting animals or ani-*
 16 *mal products.”.*

17 (b) *CONFORMING AMENDMENT.*—*Section 521(b) is*
 18 *amended by adding at the end the following new paragraph:*

19 “(7) *CROSS REFERENCE.*—

“For treatment of value-added processing involv-
ing animals, see section 1388(k).”.

20 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 21 *section shall apply to taxable years beginning after the date*
 22 *of the enactment of this Act.*

1 **SEC. 308. EXTENSION OF DECLARATORY JUDGMENT PROCE-**
 2 **DURES TO FARMERS' COOPERATIVE ORGANI-**
 3 **ZATIONS.**

4 (a) *IN GENERAL.*—Section 7428(a)(1) (relating to de-
 5 claratory judgments of tax exempt organizations) is amend-
 6 ed by striking “or” at the end of subparagraph (B) and
 7 by adding at the end the following new subparagraph:

8 “(D) with respect to the initial classifica-
 9 tion or continuing classification of a cooperative
 10 as an organization described in section 521(b)
 11 which is exempt from tax under section 521(a),
 12 or”.

13 (b) *EFFECTIVE DATE.*—The amendments made by this
 14 section shall apply with respect to pleadings filed after the
 15 date of the enactment of this Act.

16 **SEC. 309. TEMPORARY SUSPENSION OF PERSONAL HOLD-**
 17 **ING COMPANY TAX.**

18 (a) *IN GENERAL.*—Section 541 (relating to imposition
 19 of personal holding company tax) is amended by adding
 20 at the end the following new sentence: “The preceding sen-
 21 tence shall not apply with respect to any taxable year to
 22 which section 1(h)(11) (as in effect on the date of the enact-
 23 ment of this sentence) applies.”.

24 (b) *EFFECTIVE DATE.*—The amendment made by this
 25 section shall apply to taxable years beginning after Decem-
 26 ber 31, 2003.

1 **SEC. 310. INCREASE IN SECTION 179 EXPENSING.**

2 (a) *IN GENERAL.*—Section 179(b)(2) (relating to re-
3 duction in limitation) is amended by inserting “50 percent
4 of” before “the amount”.

5 (b) *EFFECTIVE DATE.*—The amendment made by this
6 section shall apply to taxable years beginning after Decem-
7 ber 31, 2002.

8 **SEC. 311. THREE-YEAR CARRYBACK OF NET OPERATING**
9 **LOSSES.**

10 (a) *IN GENERAL.*—Paragraph (1) of section 172(b)
11 (relating to years to which loss may be carried) is amended
12 by adding at the end the following new subparagraph:

13 “(I) *SPECIAL RULE FOR 2003.*—In the case
14 of a net operating loss for any taxable year end-
15 ing during 2003, subparagraph (A)(i) shall be
16 applied by substituting ‘3’ for ‘2’.”

17 (b) *ELECTION TO DISREGARD 3-YEAR CARRYBACK.*—
18 Section 172 (relating to net operating loss deduction) is
19 amended by redesignating subsection (k) as subsection (l)
20 and by inserting after subsection (j) the following new sub-
21 section:

22 “(k) *ELECTION TO DISREGARD 3-YEAR CARRYBACK*
23 *FOR CERTAIN NET OPERATING LOSSES.*—Any taxpayer en-
24 titled to a 3-year carryback under subsection (b)(1)(I) from
25 any loss year may elect to have the carryback period with
26 respect to such loss year determined without regard to sub-

1 section (b)(1)(I). Such election shall be made in such man-
 2 ner as may be prescribed by the Secretary and shall be
 3 made by the due date (including extensions of time) for fil-
 4 ing the taxpayer's return for the taxable year of the net
 5 operating loss. Such election, once made for any taxable
 6 year, shall be irrevocable for such taxable year.”.

7 (c) TEMPORARY SUSPENSION OF 90 PERCENT LIMIT
 8 ON CERTAIN NOL CARRYOVERS.—

9 (1) IN GENERAL.—Section 56(d)(1)(A)(ii)(I) (re-
 10 lating to general rule defining alternative tax net op-
 11 erating loss deduction) is amended—

12 (A) by striking “or 2002” and inserting “,
 13 2002, or 2003”, and

14 (B) by striking “and 2002” and inserting
 15 “, 2002, and 2003”.

16 (d) TECHNICAL CORRECTIONS.—

17 (1) Subparagraph (H) of section 172(b)(1) is
 18 amended by striking “a taxpayer which has”.

19 (2) Section 102(c)(2) of the Job Creation and
 20 Worker Assistance Act of 2002 (Public Law 107–147)
 21 is amended by striking “before January 1, 2003” and
 22 inserting “after December 31, 1990”.

23 (3)(A) Subclause (I) of section 56(d)(1)(A)(i) is
 24 amended by striking “attributable to carryovers”.

1 (B) Subclause (I) of section 56(d)(1)(A)(ii) is
2 amended—

3 (i) by striking “for taxable years” and in-
4 serting “from taxable years”, and

5 (ii) by striking “carryforwards” and insert-
6 ing “carryovers”.

7 (e) *EFFECTIVE DATES.*—

8 (1) *IN GENERAL.*—Except as provided in para-
9 graph (2), the amendments made by this section shall
10 apply to net operating losses for taxable years ending
11 after December 31, 2002.

12 (2) *TECHNICAL CORRECTIONS.*—The amend-
13 ments made by subsection (d) shall take effect as if
14 included in the amendments made by section 102 of
15 the Job Creation and Worker Assistance Act of 2002.

16 (3) *ELECTION.*—In the case of a net operating
17 loss for a taxable year ending during 2003—

18 (A) any election made under section
19 172(b)(3) of such Code may (notwithstanding
20 such section) be revoked before April 15, 2004,
21 and

22 (B) any election made under section 172(k)
23 (as added by this section) of such Code shall
24 (notwithstanding such section) be treated as
25 timely made if made before April 15, 2004.

**Subtitle B—Manufacturing
Relating to Films**

**SEC. 321. SPECIAL RULES FOR CERTAIN FILM AND TELE-
VISION PRODUCTIONS.**

(a) *IN GENERAL.*—Part VI of subchapter B of chapter 1 is amended by inserting after section 180 the following new section:

**“SEC. 181. TREATMENT OF QUALIFIED FILM AND TELE-
VISION PRODUCTIONS.**

**“(a) ELECTION TO TREAT CERTAIN COSTS OF QUALI-
FIED FILM AND TELEVISION PRODUCTIONS AS EX-
PENSES.—**

“(1) IN GENERAL.—A taxpayer may elect to treat the cost of any qualified film or television production as an expense which is not chargeable to capital account. Any cost so treated shall be allowed as a deduction.

“(2) DOLLAR LIMITATION.—

“(A) IN GENERAL.—The aggregate cost which may be taken into account under paragraph (1) with respect to each qualified film or television production shall not exceed \$15,000,000.

**“(B) HIGHER DOLLAR LIMITATION FOR
PRODUCTIONS IN CERTAIN AREAS.—***In the case*

1 of any qualified film or television production the
 2 aggregate cost of which is significantly incurred
 3 in an area eligible for designation as—

4 “(i) a low-income community under
 5 section 45D, or

6 “(ii) a distressed county or isolated
 7 area of distress by the Delta Regional Au-
 8 thority established under section 2009aa-1
 9 of title 7, United States Code,

10 subparagraph (A) shall be applied by sub-
 11 stituting ‘\$20,000,000’ for ‘\$15,000,000’.

12 “(b) AMORTIZATION OF REMAINING COSTS.—

13 “(1) IN GENERAL.—If an election is made under
 14 subsection (a) with respect to any qualified film or
 15 television production, that portion of the basis of such
 16 production in excess of the amount taken into account
 17 under subsection (a) shall be allowed as a deduction
 18 ratably over the 36-month period beginning with the
 19 month in which such production is placed in service.

20 “(2) NO OTHER DEDUCTION OR AMORTIZATION
 21 DEDUCTION ALLOWABLE.—With respect to the basis of
 22 any qualified film or television production described
 23 in paragraph (1), no other depreciation or amortiza-
 24 tion deduction shall be allowable.

25 “(c) ELECTION.—

1 “(1) *IN GENERAL.*—An election under subsection
 2 (a) with respect to any qualified film or television
 3 production shall be made in such manner as pre-
 4 scribed by the Secretary and by the due date (includ-
 5 ing extensions) for filing the taxpayer’s return of tax
 6 under this chapter for the taxable year in which costs
 7 of the production are first incurred.

8 “(2) *REVOCATION OF ELECTION.*—Any election
 9 made under subsection (a) may not be revoked with-
 10 out the consent of the Secretary.

11 “(d) *QUALIFIED FILM OR TELEVISION PRODUCTION.*—
 12 For purposes of this section—

13 “(1) *IN GENERAL.*—The term ‘qualified film or
 14 television production’ means any production described
 15 in paragraph (2) if 75 percent of the total compensa-
 16 tion of the production is qualified compensation.

17 “(2) *PRODUCTION.*—

18 “(A) *IN GENERAL.*—A production is de-
 19 scribed in this paragraph if such production is
 20 property described in section 168(f)(3). For pur-
 21 poses of a television series, only the first 44 epi-
 22 sodes of such series may be taken into account.

23 “(B) *EXCEPTION.*—A production is not de-
 24 scribed in this paragraph if records are required
 25 under section 2257 of title 18, United States

1 *Code, to be maintained with respect to any per-*
 2 *former in such production.*

3 “(3) *QUALIFIED COMPENSATION.—For purposes*
 4 *of paragraph (1)—*

5 “(A) *IN GENERAL.—The term ‘qualified*
 6 *compensation’ means compensation for services*
 7 *performed in the United States by actors, direc-*
 8 *tors, producers, and other relevant production*
 9 *personnel.*

10 “(B) *PARTICIPATIONS AND RESIDUALS EX-*
 11 *CLUDED.—The term ‘compensation’ does not in-*
 12 *clude participations and residuals (as defined in*
 13 *section 167(g)(7)(B)).*

14 “(e) *APPLICATION OF CERTAIN OTHER RULES.—For*
 15 *purposes of this section, rules similar to the rules of sub-*
 16 *sections (b)(2) and (c)(4) of section 194 shall apply.*

17 “(f) *TERMINATION.—This section shall not apply to*
 18 *qualified film and television productions commencing after*
 19 *December 31, 2008.”.*

20 “(b) *CONFORMING AMENDMENT.—The table of sections*
 21 *for part VI of subchapter B of chapter 1 is amended by*
 22 *inserting after the item relating to section 180 the following*
 23 *new item:*

 “Sec. 181. *Treatment of qualified film and television productions.”.*

24 “(c) *EFFECTIVE DATE.—The amendments made by this*
 25 *section shall apply to qualified film and television produc-*

1 tions (as defined in section 181(d)(1) of the Internal Rev-
 2 enue Code of 1986, as added by this section) commencing
 3 after the date of the enactment of this Act.

4 **SEC. 322. MODIFICATION OF APPLICATION OF INCOME**
 5 **FORECAST METHOD OF DEPRECIATION.**

6 (a) *IN GENERAL.*—Section 167(g) (relating to depre-
 7 ciation under income forecast method) is amended by add-
 8 ing at the end the following new paragraph:

9 “(7) *TREATMENT OF PARTICIPATIONS AND RE-*
 10 *SIDUALS.*—

11 “(A) *IN GENERAL.*—For purposes of deter-
 12 mining the depreciation deduction allowable
 13 with respect to a property under this subsection,
 14 the taxpayer may include participations and re-
 15 siduals with respect to such property in the ad-
 16 justed basis of such property for the taxable year
 17 in which the property is placed in service, but
 18 only to the extent that such participations and
 19 residuals relate to income estimated (for pur-
 20 poses of this subsection) to be earned in connec-
 21 tion with the property before the close of the 10th
 22 taxable year referred to in paragraph (1)(A).

23 “(B) *PARTICIPATIONS AND RESIDUALS.*—
 24 For purposes of this paragraph, the term ‘par-
 25 ticipations and residuals’ means, with respect to

1 *any property, costs the amount of which by con-*
 2 *tract varies with the amount of income earned*
 3 *in connection with such property.*

4 *“(C) SPECIAL RULES RELATING TO RE-*
 5 *COMPUTATION YEARS.—If the adjusted basis of*
 6 *any property is determined under this para-*
 7 *graph, paragraph (4) shall be applied by sub-*
 8 *stituting ‘for each taxable year in such period’*
 9 *for ‘for such period’.*

10 *“(D) OTHER SPECIAL RULES.—*

11 *“(i) PARTICIPATIONS AND RESIDU-*
 12 *ALS.—Notwithstanding subparagraph (A),*
 13 *the taxpayer may exclude participations*
 14 *and residuals from the adjusted basis of*
 15 *such property and deduct such participa-*
 16 *tions and residuals in the taxable year that*
 17 *such participations and residuals are paid.*

18 *“(ii) COORDINATION WITH OTHER*
 19 *RULES.—Deductions computed in accord-*
 20 *ance with this paragraph shall be allowable*
 21 *notwithstanding paragraph (1)(B) or sec-*
 22 *tions 263, 263A, 404, 419, or 461(h).*

23 *“(E) AUTHORITY TO MAKE ADJUST-*
 24 *MENTS.—The Secretary shall prescribe appro-*
 25 *priate adjustments to the basis of property and*

1 to the look-back method for the additional
2 amounts allowable as a deduction solely by rea-
3 son of this paragraph.”.

4 (b) DETERMINATION OF INCOME.—Section 167(g)(5)
5 (relating to special rules) is amended by redesignating sub-
6 paragraphs (E) and (F) as subparagraphs (F) and (G), re-
7 spectively, and inserting after subparagraph (D) the fol-
8 lowing new subparagraph:

9 “(E) TREATMENT OF DISTRIBUTION
10 COSTS.—For purposes of this subsection, the in-
11 come with respect to any property shall be the
12 taxpayer’s gross income from such property.”.

13 (c) EFFECTIVE DATE.—The amendments made by this
14 section shall apply to property placed in service after the
15 date of the enactment of this Act.

16 **Subtitle C—Manufacturing** 17 **Relating to Timber**

18 **SEC. 331. EXPENSING OF CERTAIN REFORESTATION EX-** 19 **PENDITURES.**

20 (a) IN GENERAL.—So much of subsection (b) of section
21 194 (relating to amortization of reforestation expenditures)
22 as precedes paragraph (2) is amended to read as follows:

23 “(b) TREATMENT AS EXPENSES.—

24 “(1) ELECTION TO TREAT CERTAIN REFOREST-
25 ATION EXPENDITURES AS EXPENSES.—

1 “(A) *IN GENERAL.*—*In the case of any*
 2 *qualified timber property with respect to which*
 3 *the taxpayer has made (in accordance with regu-*
 4 *lations prescribed by the Secretary) an election*
 5 *under this subsection, the taxpayer shall treat re-*
 6 *forestation expenditures which are paid or in-*
 7 *curring during the taxable year with respect to*
 8 *such property as an expense which is not charge-*
 9 *able to capital account. The reforestation expend-*
 10 *itures so treated shall be allowed as a deduction.*

11 “(B) *DOLLAR LIMITATION.*—*The aggregate*
 12 *amount of reforestation expenditures which may*
 13 *be taken into account under subparagraph (A)*
 14 *with respect to each qualified timber property for*
 15 *any taxable year shall not exceed \$10,000*
 16 *(\$5,000 in the case of a separate return by a*
 17 *married individual (as defined in section*
 18 *7703)).”.*

19 (b) *NET AMORTIZABLE BASIS.*—*Section 194(c)(2) (de-*
 20 *fining amortizable basis) is amended by inserting “which*
 21 *have not been taken into account under subsection (b)” after*
 22 *“expenditures”.*

23 (c) *CONFORMING AMENDMENTS.*—

24 (1) *Section 194(b) is amended by striking para-*
 25 *graphs (3) and (4).*

1 (2) Section 194(b)(2) is amended by striking
2 “paragraph (1)” both places it appears and inserting
3 “paragraph (1)(B)”.

4 (3) Section 194(c) is amended by striking para-
5 graph (4) and inserting the following new para-
6 graphs:

7 “(4) TREATMENT OF TRUSTS AND ESTATES.—

8 “(A) IN GENERAL.—Except as provided in
9 subparagraph (B), this section shall not apply to
10 trusts and estates.

11 “(B) AMORTIZATION DEDUCTION ALLOWED
12 TO ESTATES.—The benefit of the deduction for
13 amortization provided by subsection (a) shall be
14 allowed to estates in the same manner as in the
15 case of an individual. The allowable deduction
16 shall be apportioned between the income bene-
17 ficiary and the fiduciary under regulations pre-
18 scribed by the Secretary. Any amount so appor-
19 tioned to a beneficiary shall be taken into ac-
20 count for purposes of determining the amount al-
21 lowable as a deduction under subsection (a) to
22 such beneficiary.

23 “(5) APPLICATION WITH OTHER DEDUCTIONS.—

24 No deduction shall be allowed under any other provi-
25 sion of this chapter with respect to any expenditure

1 *with respect to which a deduction is allowed or allow-*
 2 *able under this section to the taxpayer .”.*

3 (4) *The heading for section 194 is amended by*
 4 *striking “AMORTIZATION” and inserting “TREAT-*
 5 *MENT”.*

6 (5) *The item relating to section 194 in the table*
 7 *of sections for part VI of subchapter B of chapter 1*
 8 *is amended by striking “Amortization” and inserting*
 9 *“Treatment”.*

10 (d) *REPEAL OF REFORESTATION CREDIT.—*

11 (1) *IN GENERAL.—Section 46 (relating to*
 12 *amount of credit) is amended—*

13 (A) *by adding “and” at the end of para-*
 14 *graph (1),*

15 (B) *by striking “, and ” at the end of para-*
 16 *graph (2) and inserting a period, and*

17 (C) *by striking paragraph (3).*

18 (2) *CONFORMING AMENDMENTS.—*

19 (A) *Section 48 is amended—*

20 (i) *by striking subsection (b),*

21 (ii) *by striking “this subsection” in*
 22 *paragraph (5) of subsection (a) and insert-*
 23 *ing “subsection (a)”, and*

24 (iii) *by redesignating such paragraph*
 25 *(5) as subsection (b).*

1 (B) The heading for section 48 is amended
2 by striking “; **REFORESTATION CREDIT**”.

3 (C) The item relating to section 48 in the
4 table of sections for subpart E of part IV of sub-
5 chapter A of chapter 1 is amended by striking “,
6 reforestation credit”.

7 (D) Section 50(c)(3) is amended by striking
8 “or reforestation credit”.

9 (e) **EFFECTIVE DATE.**—The amendments made by this
10 section shall apply with respect to expenditures paid or in-
11 curred after the date of the enactment of this Act.

12 **SEC. 332. ELECTION TO TREAT CUTTING OF TIMBER AS A**
13 **SALE OR EXCHANGE.**

14 Any election under section 631(a) of the Internal Rev-
15 enue Code of 1986 made for a taxable year ending on or
16 before the date of the enactment of this Act may be revoked
17 by the taxpayer for any taxable year ending after such date.
18 For purposes of determining whether the taxpayer may
19 make a further election under such section, such election
20 (and any revocation under this section) shall not be taken
21 into account.

1 **SEC. 333. CAPITAL GAIN TREATMENT UNDER SECTION**
 2 **631(b) TO APPLY TO OUTRIGHT SALES BY**
 3 **LANDOWNERS.**

4 (a) *IN GENERAL.*—*The first sentence of section 631(b)*
 5 *(relating to disposal of timber with a retained economic in-*
 6 *terest) is amended by striking “retains an economic interest*
 7 *in such timber” and inserting “either retains an economic*
 8 *interest in such timber or makes an outright sale of such*
 9 *timber”.*

10 (b) *CONFORMING AMENDMENTS.*—

11 (1) *The third sentence of section 631(b) is*
 12 *amended by striking “The date of disposal” and in-*
 13 *serting “In the case of disposal of timber with a re-*
 14 *tained economic interest, the date of disposal”.*

15 (2) *The heading for section 631(b) is amended by*
 16 *striking “WITH A RETAINED ECONOMIC INTEREST”.*

17 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 18 *section shall apply to sales after the date of the enactment*
 19 *of this Act.*

20 **SEC. 334. MODIFICATION OF SAFE HARBOR RULES FOR TIM-**
 21 **BER REITS.**

22 (a) *EXPANSION OF PROHIBITED TRANSACTION SAFE*
 23 *HARBOR.*—*Section 857(b)(6) (relating to income from pro-*
 24 *hibited transactions) is amended by redesignating subpara-*
 25 *graphs (D) and (E) as subparagraphs (E) and (F), respec-*

1 tively, and by inserting after subparagraph (C) the fol-
 2 lowing new subparagraph:

3 “(D) CERTAIN SALES NOT TO CONSTITUTE
 4 PROHIBITED TRANSACTIONS.—For purposes of
 5 this part, the term ‘prohibited transaction’ does
 6 not include a sale of property which is a real es-
 7 tate asset (as defined in section 856(c)(5)(B))
 8 if—

9 “(i) the trust held the property for not
 10 less than 4 years in connection with the
 11 trade or business of producing timber,

12 “(ii) the aggregate expenditures made
 13 by the trust, or a partner of the trust, dur-
 14 ing the 4-year period preceding the date of
 15 sale which—

16 “(I) are includible in the basis of
 17 the property (other than timberland
 18 acquisition expenditures), and

19 “(II) are directly related to oper-
 20 ation of the property for the produc-
 21 tion of timber or for the preservation of
 22 the property for use as timberland,
 23 do not exceed 30 percent of the net selling
 24 price of the property,

1 “(iii) the aggregate expenditures made
2 by the trust, or a partner of the trust, dur-
3 ing the 4-year period preceding the date of
4 sale which—

5 “(I) are includible in the basis of
6 the property (other than timberland
7 acquisition expenditures), and

8 “(II) are not directly related to
9 operation of the property for the pro-
10 duction of timber, or for the preserva-
11 tion of the property for use as
12 timberland,

13 do not exceed 5 percent of the net selling
14 price of the property,

15 “(iv)(I) during the taxable year the
16 trust does not make more than 7 sales of
17 property (other than sales of foreclosure
18 property or sales to which section 1033 ap-
19 plies), or

20 “(II) the aggregate adjusted bases (as
21 determined for purposes of computing earn-
22 ings and profits) of property (other than
23 sales of foreclosure property or sales to
24 which section 1033 applies) sold during the
25 taxable year does not exceed 10 percent of

1 the aggregate bases (as so determined) of all
2 of the assets of the trust as of the beginning
3 of the taxable year,

4 “(v) in the case that the requirement of
5 clause (iv)(I) is not satisfied, substantially
6 all of the marketing expenditures with re-
7 spect to the property were made through an
8 independent contractor (as defined in sec-
9 tion 856(d)(3)) from whom the trust itself
10 does not derive or receive any income, and

11 “(vi) the sales price of the property
12 sold by the trust is not based in whole or in
13 part on income or profits, including income
14 or profits derived from the sale or operation
15 of such property.”.

16 (b) *EFFECTIVE DATE.*—The amendments made by this
17 section shall apply to taxable years beginning after the date
18 of the enactment of this Act.

1 **TITLE IV—ADDITIONAL**
 2 **PROVISIONS**
 3 **Subtitle A—Provisions Designed To**
 4 **Curtail Tax Shelters**

5 **SEC. 401. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 6 **TRINE.**

7 (a) *IN GENERAL.*—Section 7701 is amended by redes-
 8 ignating subsection (n) as subsection (o) and by inserting
 9 after subsection (m) the following new subsection:

10 “(n) *CLARIFICATION OF ECONOMIC SUBSTANCE DOC-*
 11 *TRINE; ETC.*—

12 “(1) *GENERAL RULES.*—

13 “(A) *IN GENERAL.*—In any case in which a
 14 court determines that the economic substance
 15 doctrine is relevant for purposes of this title to
 16 a transaction (or series of transactions), such
 17 transaction (or series of transactions) shall have
 18 economic substance only if the requirements of
 19 this paragraph are met.

20 “(B) *DEFINITION OF ECONOMIC SUB-*
 21 *STANCE.*—For purposes of subparagraph (A)—

22 “(i) *IN GENERAL.*—A transaction has
 23 economic substance only if—

24 “(I) the transaction changes in a
 25 meaningful way (apart from Federal

1 *tax effects) the taxpayer's economic po-*
 2 *sition, and*

3 *“(II) the taxpayer has a substan-*
 4 *tial nontax purpose for entering into*
 5 *such transaction and the transaction is*
 6 *a reasonable means of accomplishing*
 7 *such purpose.*

8 *In applying subclause (II), a purpose of*
 9 *achieving a financial accounting benefit*
 10 *shall not be taken into account in deter-*
 11 *mining whether a transaction has a sub-*
 12 *stantial nontax purpose if the origin of such*
 13 *financial accounting benefit is a reduction*
 14 *of income tax.*

15 *“(ii) SPECIAL RULE WHERE TAXPAYER*
 16 *RELIES ON PROFIT POTENTIAL.—A trans-*
 17 *action shall not be treated as having eco-*
 18 *nomie substance by reason of having a po-*
 19 *tential for profit unless—*

20 *“(I) the present value of the rea-*
 21 *sonably expected pre-tax profit from*
 22 *the transaction is substantial in rela-*
 23 *tion to the present value of the expected*
 24 *net tax benefits that would be allowed*
 25 *if the transaction were respected, and*

1 “(II) the reasonably expected pre-
2 tax profit from the transaction exceeds
3 a risk-free rate of return.

4 “(C) TREATMENT OF FEES AND FOREIGN
5 TAXES.—Fees and other transaction expenses
6 and foreign taxes shall be taken into account as
7 expenses in determining pre-tax profit under
8 subparagraph (B)(ii).

9 “(2) SPECIAL RULES FOR TRANSACTIONS WITH
10 TAX-INDIFFERENT PARTIES.—

11 “(A) SPECIAL RULES FOR FINANCING
12 TRANSACTIONS.—The form of a transaction
13 which is in substance the borrowing of money or
14 the acquisition of financial capital directly or
15 indirectly from a tax-indifferent party shall not
16 be respected if the present value of the deductions
17 to be claimed with respect to the transaction is
18 substantially in excess of the present value of the
19 anticipated economic returns of the person lend-
20 ing the money or providing the financial capital.
21 A public offering shall be treated as a borrowing,
22 or an acquisition of financial capital, from a
23 tax-indifferent party if it is reasonably expected
24 that at least 50 percent of the offering will be
25 placed with tax-indifferent parties.

1 “(B) *ARTIFICIAL INCOME SHIFTING AND*
 2 *BASIS ADJUSTMENTS.*—*The form of a trans-*
 3 *action with a tax-indifferent party shall not be*
 4 *respected if—*

5 “(i) *it results in an allocation of in-*
 6 *come or gain to the tax-indifferent party in*
 7 *excess of such party’s economic income or*
 8 *gain, or*

9 “(ii) *it results in a basis adjustment or*
 10 *shifting of basis on account of overstating*
 11 *the income or gain of the tax-indifferent*
 12 *party.*

13 “(3) *DEFINITIONS AND SPECIAL RULES.*—*For*
 14 *purposes of this subsection—*

15 “(A) *ECONOMIC SUBSTANCE DOCTRINE.*—
 16 *The term ‘economic substance doctrine’ means*
 17 *the common law doctrine under which tax bene-*
 18 *fits under subtitle A with respect to a trans-*
 19 *action are not allowable if the transaction does*
 20 *not have economic substance or lacks a business*
 21 *purpose.*

22 “(B) *TAX-INDIFFERENT PARTY.*—*The term*
 23 *‘tax-indifferent party’ means any person or enti-*
 24 *ty not subject to tax imposed by subtitle A. A*
 25 *person shall be treated as a tax-indifferent party*

1 with respect to a transaction if the items taken
 2 into account with respect to the transaction have
 3 no substantial impact on such person's liability
 4 under subtitle A.

5 “(C) EXCEPTION FOR PERSONAL TRANS-
 6 ACTIONS OF INDIVIDUALS.—In the case of an in-
 7 dividual, this subsection shall apply only to
 8 transactions entered into in connection with a
 9 trade or business or an activity engaged in for
 10 the production of income.

11 “(D) TREATMENT OF LESSORS.—In apply-
 12 ing paragraph (1)(B)(ii) to the lessor of tangible
 13 property subject to a lease—

14 “(i) the expected net tax benefits with
 15 respect to the leased property shall not in-
 16 clude the benefits of—

17 “(I) depreciation,

18 “(II) any tax credit, or

19 “(III) any other deduction as pro-
 20 vided in guidance by the Secretary,
 21 and

22 “(ii) subclause (II) of paragraph
 23 (1)(B)(ii) shall be disregarded in deter-
 24 mining whether any of such benefits are al-
 25 lowable.

“(4) OTHER COMMON LAW DOCTRINES NOT AFFECTED.—Except as specifically provided in this subsection, the provisions of this subsection shall not be construed as altering or supplanting any other rule of law, and the requirements of this subsection shall be construed as being in addition to any such other rule of law.

“(5) *REGULATIONS.*—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection. Such regulations may include exemptions from the application of this subsection.”.

(b) *EFFECTIVE DATE.*—The amendments made by this section shall apply to transactions entered into after the date of the enactment of this Act.

SEC. 402. PENALTY FOR FAILING TO DISCLOSE REPORT.
ABLE TRANSACTION.

(a) *IN GENERAL.*—Part I of subchapter B of chapter 68 (relating to assessable penalties) is amended by inserting after section 6707 the following new section:

**"SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-
ABLE TRANSACTION INFORMATION WITH RE-
TURN OR STATEMENT.**

24 “(a) *IMPOSITION OF PENALTY.*—Any person who fails
25 to include on any return or statement any information with

1 *respect to a reportable transaction which is required under*
 2 *section 6011 to be included with such return or statement*
 3 *shall pay a penalty in the amount determined under sub-*
 4 *section (b).*

5 *“(b) AMOUNT OF PENALTY.—*

6 *“(1) IN GENERAL.—Except as provided in para-*
 7 *graphs (2) and (3), the amount of the penalty under*
 8 *subsection (a) shall be \$50,000.*

9 *“(2) LISTED TRANSACTION.—The amount of the*
 10 *penalty under subsection (a) with respect to a listed*
 11 *transaction shall be \$100,000.*

12 *“(3) INCREASE IN PENALTY FOR LARGE ENTITIES*
 13 *AND HIGH NET WORTH INDIVIDUALS.—*

14 *“(A) IN GENERAL.—In the case of a failure*
 15 *under subsection (a) by—*

16 *“(i) a large entity, or*

17 *“(ii) a high net worth individual,*

18 *the penalty under paragraph (1) or (2) shall be*
 19 *twice the amount determined without regard to*
 20 *this paragraph.*

21 *“(B) LARGE ENTITY.—For purposes of sub-*
 22 *paragraph (A), the term ‘large entity’ means,*
 23 *with respect to any taxable year, a person (other*
 24 *than a natural person) with gross receipts in ex-*
 25 *cess of \$10,000,000 for the taxable year in which*

1 the reportable transaction occurs or the pre-
 2 ceding taxable year. Rules similar to the rules of
 3 paragraph (2) and subparagraphs (B), (C), and
 4 (D) of paragraph (3) of section 448(c) shall
 5 apply for purposes of this subparagraph.

6 “(C) *HIGH NET WORTH INDIVIDUAL.*—For
 7 purposes of subparagraph (A), the term ‘high net
 8 worth individual’ means, with respect to a re-
 9 portable transaction, a natural person whose net
 10 worth exceeds \$2,000,000 immediately before the
 11 transaction.

12 “(c) *DEFINITIONS.*—For purposes of this section—

13 “(1) *REPORTABLE TRANSACTION.*—The term ‘re-
 14 portable transaction’ means any transaction with re-
 15 spect to which information is required to be included
 16 with a return or statement because, as determined
 17 under regulations prescribed under section 6011, such
 18 transaction is of a type which the Secretary deter-
 19 mines as having a potential for tax avoidance or eva-
 20 sion.

21 “(2) *LISTED TRANSACTION.*—Except as provided
 22 in regulations, the term ‘listed transaction’ means a
 23 reportable transaction which is the same as, or sub-
 24 stantially similar to, a transaction specifically identi-

1 *fied by the Secretary as a tax avoidance transaction*
 2 *for purposes of section 6011.*

3 “(d) *AUTHORITY TO RESCIND PENALTY.*—

4 “(1) *IN GENERAL.*—*The Commissioner of Inter-*
 5 *nal Revenue may rescind all or any portion of any*
 6 *penalty imposed by this section with respect to any*
 7 *violation if—*

8 “(A) *the violation is with respect to a re-*
 9 *portable transaction other than a listed trans-*
 10 *action,*

11 “(B) *the person on whom the penalty is im-*
 12 *posed has a history of complying with the re-*
 13 *quirements of this title,*

14 “(C) *it is shown that the violation is due to*
 15 *an unintentional mistake of fact;*

16 “(D) *imposing the penalty would be against*
 17 *equity and good conscience, and*

18 “(E) *rescinding the penalty would promote*
 19 *compliance with the requirements of this title*
 20 *and effective tax administration.*

21 “(2) *DISCRETION.*—*The exercise of authority*
 22 *under paragraph (1) shall be at the sole discretion of*
 23 *the Commissioner and may be delegated only to the*
 24 *head of the Office of Tax Shelter Analysis. The Com-*
 25 *missioner, in the Commissioner’s sole discretion, may*

1 *establish a procedure to determine if a penalty should*
 2 *be referred to the Commissioner or the head of such*
 3 *Office for a determination under paragraph (1).*

4 “(3) *NO APPEAL.*—*Notwithstanding any other*
 5 *provision of law, any determination under this sub-*
 6 *section may not be reviewed in any administrative or*
 7 *judicial proceeding.*

8 “(4) *RECORDS.*—*If a penalty is rescinded under*
 9 *paragraph (1), the Commissioner shall place in the*
 10 *file in the Office of the Commissioner the opinion of*
 11 *the Commissioner or the head of the Office of Tax*
 12 *Shelter Analysis with respect to the determination,*
 13 *including—*

14 “(A) *the facts and circumstances of the*
 15 *transaction,*

16 “(B) *the reasons for the rescission, and*

17 “(C) *the amount of the penalty rescinded.*

18 “(5) *REPORT.*—*The Commissioner shall each*
 19 *year report to the Committee on Ways and Means of*
 20 *the House of Representatives and the Committee on*
 21 *Finance of the Senate—*

22 “(A) *a summary of the total number and*
 23 *aggregate amount of penalties imposed, and re-*
 24 *scinded, under this section, and*

1 “(B) a description of each penalty rescinded
2 under this subsection and the reasons therefor.

3 “(e) *PENALTY REPORTED TO SEC.*—In the case of a
4 person—

5 “(1) which is required to file periodic reports
6 under section 13 or 15(d) of the Securities Exchange
7 Act of 1934 or is required to be consolidated with an-
8 other person for purposes of such reports, and

9 “(2) which—

10 “(A) is required to pay a penalty under
11 this section with respect to a listed transaction,

12 “(B) is required to pay a penalty under sec-
13 tion 6662A with respect to any reportable trans-
14 action at a rate prescribed under section
15 6662A(c), or

16 “(C) is required to pay a penalty under sec-
17 tion 6662B with respect to any noneconomic
18 substance transaction,

19 the requirement to pay such penalty shall be disclosed in
20 such reports filed by such person for such periods as the
21 Secretary shall specify. Failure to make a disclosure in ac-
22 cordance with the preceding sentence shall be treated as a
23 failure to which the penalty under subsection (b)(2) applies.

1 “(f) *COORDINATION WITH OTHER PENALTIES.*—The
2 penalty imposed by this section is in addition to any pen-
3 alty imposed under this title.”.

4 (b) *CONFORMING AMENDMENT.*—The table of sections
5 for part I of subchapter B of chapter 68 is amended by
6 inserting after the item relating to section 6707 the fol-
7 lowing:

“Sec. 6707A. Penalty for failure to include reportable transaction
information with return or statement.”.

8 (c) *EFFECTIVE DATE.*—The amendments made by this
9 section shall apply to returns and statements the due date
10 for which is after the date of the enactment of this Act.

11 **SEC. 403. ACCURACY-RELATED PENALTY FOR LISTED**
12 **TRANSACTIONS AND OTHER REPORTABLE**
13 **TRANSACTIONS HAVING A SIGNIFICANT TAX**
14 **AVOIDANCE PURPOSE.**

15 (a) *IN GENERAL.*—Subchapter A of chapter 68 is
16 amended by inserting after section 6662 the following new
17 section:

18 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PENALTY**
19 **ON UNDERSTATEMENTS WITH RESPECT TO**
20 **REPORTABLE TRANSACTIONS.**

21 “(a) *IMPOSITION OF PENALTY.*—If a taxpayer has a
22 reportable transaction understatement for any taxable year,
23 there shall be added to the tax an amount equal to 20 per-
24 cent of the amount of such understatement.

1 “(b) *REPORTABLE TRANSACTION UNDERSTATE-*
2 *MENT.—For purposes of this section—*

3 “(1) *IN GENERAL.—The term ‘reportable trans-*
4 *action understatement’ means the sum of—*

5 “(A) *the product of—*

6 “(i) *the amount of the increase (if any)*
7 *in taxable income which results from a dif-*
8 *ference between the proper tax treatment of*
9 *an item to which this section applies and*
10 *the taxpayer’s treatment of such item (as*
11 *shown on the taxpayer’s return of tax), and*

12 “(ii) *the highest rate of tax imposed by*
13 *section 1 (section 11 in the case of a tax-*
14 *payer which is a corporation), and*

15 “(B) *the amount of the decrease (if any) in*
16 *the aggregate amount of credits determined*
17 *under subtitle A which results from a difference*
18 *between the taxpayer’s treatment of an item to*
19 *which this section applies (as shown on the tax-*
20 *payer’s return of tax) and the proper tax treat-*
21 *ment of such item.*

22 *For purposes of subparagraph (A), any reduction of*
23 *the excess of deductions allowed for the taxable year*
24 *over gross income for such year, and any reduction*
25 *in the amount of capital losses which would (without*

1 regard to section 1211) be allowed for such year, shall
 2 be treated as an increase in taxable income.

3 “(2) *ITEMS TO WHICH SECTION APPLIES.*—This
 4 section shall apply to any item which is attributable
 5 to—

6 “(A) any listed transaction, and

7 “(B) any reportable transaction (other than
 8 a listed transaction) if a significant purpose of
 9 such transaction is the avoidance or evasion of
 10 Federal income tax.

11 “(c) *HIGHER PENALTY FOR NONDISCLOSED LISTED*
 12 *AND OTHER AVOIDANCE TRANSACTIONS.*—

13 “(1) *IN GENERAL.*—Subsection (a) shall be ap-
 14 plied by substituting ‘30 percent’ for ‘20 percent’ with
 15 respect to the portion of any reportable transaction
 16 understatement with respect to which the requirement
 17 of section 6664(d)(2)(A) is not met.

18 “(2) *RULES APPLICABLE TO ASSERTION AND*
 19 *COMPROMISE OF PENALTY.*—

20 “(A) *IN GENERAL.*—Only upon the ap-
 21 proval by the Chief Counsel for the Internal Rev-
 22 enue Service or the Chief Counsel’s delegate at
 23 the national office of the Internal Revenue Serv-
 24 ice may a penalty to which paragraph (1) ap-
 25 plies be included in a 1st letter of proposed defi-

1 *ciency which allows the taxpayer an opportunity*
 2 *for administrative review in the Internal Rev-*
 3 *enue Service Office of Appeals. If such a letter is*
 4 *provided to the taxpayer, only the Commissioner*
 5 *of Internal Revenue may compromise all or any*
 6 *portion of such penalty.*

7 *“(B) APPLICABLE RULES.—The rules of*
 8 *paragraphs (2), (3), (4), and (5) of section*
 9 *6707A(d) shall apply for purposes of subpara-*
 10 *graph (A).*

11 *“(d) DEFINITIONS OF REPORTABLE AND LISTED*
 12 *TRANSACTIONS.—For purposes of this section, the terms ‘re-*
 13 *portable transaction’ and ‘listed transaction’ have the re-*
 14 *spective meanings given to such terms by section 6707A(c).*

15 *“(e) SPECIAL RULES.—*

16 *“(1) COORDINATION WITH PENALTIES, ETC., ON*
 17 *OTHER UNDERSTATEMENTS.—In the case of an under-*
 18 *statement (as defined in section 6662(d)(2))—*

19 *“(A) the amount of such understatement*
 20 *(determined without regard to this paragraph)*
 21 *shall be increased by the aggregate amount of re-*
 22 *portable transaction understatements and non-*
 23 *economic substance transaction understatements*
 24 *for purposes of determining whether such under-*

1 *statement is a substantial understatement under*
2 *section 6662(d)(1), and*

3 *“(B) the addition to tax under section*
4 *6662(a) shall apply only to the excess of the*
5 *amount of the substantial understatement (if*
6 *any) after the application of subparagraph (A)*
7 *over the aggregate amount of reportable trans-*
8 *action understatements and noneconomic sub-*
9 *stance transaction understatements.*

10 *“(2) COORDINATION WITH OTHER PENALTIES.—*

11 *“(A) APPLICATION OF FRAUD PENALTY.—*
12 *References to an underpayment in section 6663*
13 *shall be treated as including references to a re-*
14 *portable transaction understatement and a non-*
15 *economic substance transaction understatement.*

16 *“(B) NO DOUBLE PENALTY.—This section*
17 *shall not apply to any portion of an understate-*
18 *ment on which a penalty is imposed under sec-*
19 *tion 6662B or 6663.*

20 *“(3) SPECIAL RULE FOR AMENDED RETURNS.—*

21 *Except as provided in regulations, in no event shall*
22 *any tax treatment included with an amendment or*
23 *supplement to a return of tax be taken into account*
24 *in determining the amount of any reportable trans-*
25 *action understatement or noneconomic substance*

1 *transaction understatement if the amendment or sup-*
 2 *plement is filed after the earlier of the date the tax-*
 3 *payer is first contacted by the Secretary regarding*
 4 *the examination of the return or such other date as*
 5 *is specified by the Secretary.*

6 *“(4) NONECONOMIC SUBSTANCE TRANS-*
 7 *ACTION UNDERSTATEMENT.—For purposes of this*
 8 *subsection, the term ‘noneconomic substance*
 9 *transaction understatement’ has the meaning*
 10 *given such term by section 6662B(c).*

11 *“(5) CROSS REFERENCE.—*

“For reporting of section 6662A(c) penalty to the
Securities and Exchange Commission, see section
6707A(e).”.

12 (b) *DETERMINATION OF OTHER UNDERSTATE-*
 13 *MENTS.—Subparagraph (A) of section 6662(d)(2) is*
 14 *amended by adding at the end the following flush sentence:*

15 *“The excess under the preceding sentence shall be*
 16 *determined without regard to items to which sec-*
 17 *tion 6662A applies and without regard to items*
 18 *with respect to which a penalty is imposed by*
 19 *section 6662B.”.*

20 (c) *REASONABLE CAUSE EXCEPTION.—*

21 *(1) IN GENERAL.—Section 6664 is amended by*
 22 *adding at the end the following new subsection:*

23 *“(d) REASONABLE CAUSE EXCEPTION FOR REPORT-*
 24 *ABLE TRANSACTION UNDERSTATEMENTS.—*

1 “(1) *IN GENERAL.*—No penalty shall be imposed
 2 under section 6662A with respect to any portion of a
 3 reportable transaction understatement if it is shown
 4 that there was a reasonable cause for such portion
 5 and that the taxpayer acted in good faith with respect
 6 to such portion.

7 “(2) *SPECIAL RULES.*—Paragraph (1) shall not
 8 apply to any reportable transaction understatement
 9 unless—

10 “(A) the relevant facts affecting the tax
 11 treatment of the item are adequately disclosed in
 12 accordance with the regulations prescribed under
 13 section 6011,

14 “(B) there is or was substantial authority
 15 for such treatment, and

16 “(C) the taxpayer reasonably believed that
 17 such treatment was more likely than not the
 18 proper treatment.

19 A taxpayer failing to adequately disclose in accord-
 20 ance with section 6011 shall be treated as meeting the
 21 requirements of subparagraph (A) if the penalty for
 22 such failure was rescinded under section 6707A(d).

23 “(3) *RULES RELATING TO REASONABLE BE-*
 24 *LIEF.*—For purposes of paragraph (2)(C)—

1 “(A) *IN GENERAL.*—A taxpayer shall be
2 *treated as having a reasonable belief with respect*
3 *to the tax treatment of an item only if such be-*
4 *lief—*

5 “(i) *is based on the facts and law that*
6 *exist at the time the return of tax which in-*
7 *cludes such tax treatment is filed, and*

8 “(ii) *relates solely to the taxpayer's*
9 *chances of success on the merits of such*
10 *treatment and does not take into account*
11 *the possibility that a return will not be au-*
12 *dated, such treatment will not be raised on*
13 *audit, or such treatment will be resolved*
14 *through settlement if it is raised.*

15 “(B) *CERTAIN OPINIONS MAY NOT BE RE-*
16 *LIED UPON.—*

17 “(i) *IN GENERAL.*—An opinion of a
18 *tax advisor may not be relied upon to estab-*
19 *lish the reasonable belief of a taxpayer if—*

20 “(I) *the tax advisor is described*
21 *in clause (ii), or*

22 “(II) *the opinion is described in*
23 *clause (iii).*

1 “(ii) *DISQUALIFIED TAX ADVISORS.*—A
2 *tax advisor is described in this clause if the*
3 *tax advisor—*

4 “(I) *is a material advisor (within*
5 *the meaning of section 6111(b)(1)) who*
6 *participates in the organization, man-*
7 *agement, promotion, or sale of the*
8 *transaction or who is related (within*
9 *the meaning of section 267(b) or*
10 *707(b)(1)) to any person who so par-*
11 *ticipates,*

12 “(II) *is compensated directly or*
13 *indirectly by a material advisor with*
14 *respect to the transaction,*

15 “(III) *has a fee arrangement with*
16 *respect to the transaction which is con-*
17 *tingent on all or part of the intended*
18 *tax benefits from the transaction being*
19 *sustained, or*

20 “(IV) *as determined under regula-*
21 *tions prescribed by the Secretary, has a*
22 *disqualifying financial interest with*
23 *respect to the transaction.*

1 “(iii) *DISQUALIFIED OPINIONS.*—For
2 purposes of clause (i), an opinion is dis-
3 qualified if the opinion—

4 “(I) is based on unreasonable fac-
5 tual or legal assumptions (including
6 assumptions as to future events),

7 “(II) unreasonably relies on rep-
8 resentations, statements, findings, or
9 agreements of the taxpayer or any
10 other person,

11 “(III) does not identify and con-
12 sider all relevant facts, or

13 “(IV) fails to meet any other re-
14 quirement as the Secretary may pre-
15 scribe.”.

16 (2) *CONFORMING AMENDMENT.*—The heading for
17 subsection (c) of section 6664 is amended by inserting
18 “FOR UNDERPAYMENTS” after “EXCEPTION”.

19 (d) *CONFORMING AMENDMENTS.*—

20 (1) Subparagraph (C) of section 461(i)(3) is
21 amended by striking “section 6662(d)(2)(C)(iii)” and
22 inserting “section 1274(b)(3)(C)”.

23 (2) Paragraph (3) of section 1274(b) is amend-
24 ed—

1 (A) by striking “(as defined in section
2 6662(d)(2)(C)(iii))” in subparagraph (B)(i), and
3 (B) by adding at the end the following new
4 subparagraph:

5 “(C) *TAX SHELTER*.—For purposes of sub-
6 paragraph (B), the term ‘tax shelter’ means—

7 “(i) a partnership or other entity,

8 “(ii) any investment plan or arrange-
9 ment, or

10 “(iii) any other plan or arrangement,
11 if a significant purpose of such partnership, en-
12 tity, plan, or arrangement is the avoidance or
13 evasion of Federal income tax.”.

14 (3) Section 6662(d)(2) is amended by striking
15 subparagraphs (C) and (D).

16 (4) Section 6664(c)(1) is amended by striking
17 “this part” and inserting “section 6662 or 6663”.

18 (5) Subsection (b) of section 7525 is amended by
19 striking “section 6662(d)(2)(C)(iii)” and inserting
20 “section 1274(b)(3)(C)”.

21 (6)(A) The heading for section 6662 is amended
22 to read as follows:

1 **"SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY**
 2 **ON UNDERPAYMENTS."**

3 *(B) The table of sections for part II of sub-*
 4 *chapter A of chapter 68 is amended by striking the*
 5 *item relating to section 6662 and inserting the fol-*
 6 *lowing new items:*

"Sec. 6662. Imposition of accuracy-related penalty on underpay-
ments.

"Sec. 6662A. Imposition of accuracy-related penalty on understatement-
ments with respect to reportable transactions."

7 *(e) EFFECTIVE DATE.—The amendments made by this*
 8 *section shall apply to taxable years ending after the date*
 9 *of the enactment of this Act.*

10 **SEC. 404. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
 11 **UTABLE TO TRANSACTIONS LACKING ECO-**
 12 **NOMIC SUBSTANCE, ETC.**

13 *(a) IN GENERAL.—Subchapter A of chapter 68 is*
 14 *amended by inserting after section 6662A the following new*
 15 *section:*

16 **"SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
 17 **UTABLE TO TRANSACTIONS LACKING ECO-**
 18 **NOMIC SUBSTANCE, ETC.**

19 *"(a) IMPOSITION OF PENALTY.—If a taxpayer has an*
 20 *noneconomic substance transaction understatement for any*
 21 *taxable year, there shall be added to the tax an amount*
 22 *equal to 40 percent of the amount of such understatement.*

1 “(b) *REDUCTION OF PENALTY FOR DISCLOSED TRANS-*
 2 *ACTIONS.*—Subsection (a) shall be applied by substituting
 3 ‘20 percent’ for ‘40 percent’ with respect to the portion of
 4 any noneconomic substance transaction understatement
 5 with respect to which the relevant facts affecting the tax
 6 treatment of the item are adequately disclosed in the return
 7 or a statement attached to the return.

8 “(c) *NONECONOMIC SUBSTANCE TRANSACTION UNDER-*
 9 *STATEMENT.*—For purposes of this section—

10 “(1) *IN GENERAL.*—The term ‘noneconomic sub-
 11 stance transaction understatement’ means any
 12 amount which would be an understatement under sec-
 13 tion 6662A(b)(1) if section 6662A were applied by
 14 taking into account items attributable to noneconomic
 15 substance transactions rather than items to which sec-
 16 tion 6662A would apply without regard to this para-
 17 graph.

18 “(2) *NONECONOMIC SUBSTANCE TRANSACTION.*—
 19 The term ‘noneconomic substance transaction’ means
 20 any transaction if—

21 “(A) there is a lack of economic substance
 22 (within the meaning of section 7701(n)(1)) for
 23 the transaction giving rise to the claimed benefit
 24 or the transaction was not respected under sec-
 25 tion 7701(n)(2), or

1 “(B) the transaction fails to meet the re-
2 quirements of any similar rule of law.

3 “(d) *RULES APPLICABLE TO COMPROMISE OF PEN-*
4 *ALTY.—*

5 “(1) *IN GENERAL.—*If the 1st letter of proposed
6 deficiency which allows the taxpayer an opportunity
7 for administrative review in the Internal Revenue
8 Service Office of Appeals has been sent with respect
9 to a penalty to which this section applies, only the
10 Commissioner of Internal Revenue may compromise
11 all or any portion of such penalty.

12 “(2) *APPLICABLE RULES.—*The rules of para-
13 graphs (2), (3), (4), and (5) of section 6707A(d) shall
14 apply for purposes of paragraph (1).

15 “(e) *COORDINATION WITH OTHER PENALTIES.—*Ex-
16 cept as otherwise provided in this part, the penalty imposed
17 by this section shall be in addition to any other penalty
18 imposed by this title.

19 “(f) *CROSS REFERENCES.—*

 “(1) *For coordination of penalty with understatement-
 ments under section 6662 and other special rules, see
 section 6662A(e).*

 “(2) *For reporting of penalty imposed under this
 section to the Securities and Exchange Commission,
 see section 6707A(e).”.*

20 “(b) *CLERICAL AMENDMENT.—*The table of sections for
21 part II of subchapter A of chapter 68 is amended by insert-

1 ing after the item relating to section 6662A the following
 2 new item:

"Sec. 6662B. Penalty for understatements attributable to transactions lacking economic substance, etc.".

3 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 4 *section shall apply to transactions entered into after the*
 5 *date of the enactment of this Act.*

6 **SEC. 405. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
 7 **MENT PENALTY FOR NONREPORTABLE**
 8 **TRANSACTIONS.**

9 (a) *SUBSTANTIAL UNDERSTATEMENT OF CORPORA-*
 10 *TIONS.*—*Section 6662(d)(1)(B) (relating to special rule for*
 11 *corporations) is amended to read as follows:*

12 *"(B) SPECIAL RULE FOR CORPORATIONS.—*
 13 *In the case of a corporation other than an S cor-*
 14 *poration or a personal holding company (as de-*
 15 *finied in section 542), there is a substantial un-*
 16 *derstatement of income tax for any taxable year*
 17 *if the amount of the understatement for the tax-*
 18 *able year exceeds the lesser of—*

19 *"(i) 10 percent of the tax required to*
 20 *be shown on the return for the taxable year*
 21 *(or, if greater, \$10,000), or*

22 *"(ii) \$10,000,000."*

23 (b) *REDUCTION FOR UNDERSTATEMENT OF TAXPAYER*
 24 *DUE TO POSITION OF TAXPAYER OR DISCLOSED ITEM.—*

1 (1) *IN GENERAL.*—Section 6662(d)(2)(B)(i) (re-
2 *lating to substantial authority*) is amended to read as
3 *follows:*

4 “(i) *the tax treatment of any item by*
5 *the taxpayer if the taxpayer had reasonable*
6 *belief that the tax treatment was more likely*
7 *than not the proper treatment, or”.*

8 (2) *CONFORMING AMENDMENT.*—Section 6662(d)
9 *is amended by adding at the end the following new*
10 *paragraph:*

11 “(3) *SECRETARIAL LIST.*—*For purposes of this*
12 *subsection, section 6664(d)(2), and section 6694(a)(1),*
13 *the Secretary may prescribe a list of positions for*
14 *which the Secretary believes there is not substantial*
15 *authority or there is no reasonable belief that the tax*
16 *treatment is more likely than not the proper tax*
17 *treatment. Such list (and any revisions thereof) shall*
18 *be published in the Federal Register or the Internal*
19 *Revenue Bulletin.”.*

20 (c) *EFFECTIVE DATE.*—*The amendments made by this*
21 *section shall apply to taxable years beginning after the date*
22 *of the enactment of this Act.*

1 **SEC. 406. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
 2 **PRIVILEGES RELATING TO TAXPAYER COM-**
 3 **MUNICATIONS.**

4 (a) *IN GENERAL.*—Section 7525(b) (relating to section
 5 not to apply to communications regarding corporate tax
 6 shelters) is amended to read as follows:

7 “(b) *SECTION NOT TO APPLY TO COMMUNICATIONS*
 8 *REGARDING TAX SHELTERS.*—The privilege under sub-
 9 section (a) shall not apply to any written communication
 10 which is—

11 “(1) between a federally authorized tax practi-
 12 tioner and—

13 “(A) any person,

14 “(B) any director, officer, employee, agent,
 15 or representative of the person, or

16 “(C) any other person holding a capital or
 17 profits interest in the person, and

18 “(2) in connection with the promotion of the di-
 19 rect or indirect participation of the person in any tax
 20 shelter (as defined in section 1274(b)(3)(C)).”

21 (b) *EFFECTIVE DATE.*—The amendment made by this
 22 section shall apply to communications made on or after the
 23 date of the enactment of this Act.

24 **SEC. 407. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

25 (a) *IN GENERAL.*—Section 6111 (relating to registra-
 26 tion of tax shelters) is amended to read as follows:

1 **"SEC. 6111. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

2 “(a) *IN GENERAL.*—Each material advisor with re-
3 spect to any reportable transaction shall make a return (in
4 such form as the Secretary may prescribe) setting forth—

5 “(1) information identifying and describing the
6 transaction,

7 “(2) information describing any potential tax
8 benefits expected to result from the transaction, and

9 “(3) such other information as the Secretary
10 may prescribe.

11 Such return shall be filed not later than the date specified
12 by the Secretary.

13 “(b) *DEFINITIONS.*—For purposes of this section—

14 “(1) *MATERIAL ADVISOR.*—

15 “(A) *IN GENERAL.*—The term ‘material ad-
16 visor’ means any person—

17 “(i) who provides any material aid,
18 assistance, or advice with respect to orga-
19 nizing, managing, promoting, selling, im-
20 plementing, or carrying out any reportable
21 transaction, and

22 “(ii) who directly or indirectly derives
23 gross income in excess of the threshold
24 amount for such aid, assistance, or advice.

25 “(B) *THRESHOLD AMOUNT.*—For purposes
26 of subparagraph (A), the threshold amount is—

1 “(i) \$50,000 in the case of a reportable
2 transaction substantially all of the tax bene-
3 fits from which are provided to natural per-
4 sons, and

5 “(ii) \$250,000 in any other case.

6 “(2) REPORTABLE TRANSACTION.—The term ‘re-
7 portable transaction’ has the meaning given to such
8 term by section 6707A(c).

9 “(c) REGULATIONS.—The Secretary may prescribe reg-
10 ulations which provide—

11 “(1) that only 1 person shall be required to meet
12 the requirements of subsection (a) in cases in which
13 2 or more persons would otherwise be required to meet
14 such requirements,

15 “(2) exemptions from the requirements of this
16 section, and

17 “(3) such rules as may be necessary or appro-
18 priate to carry out the purposes of this section.”.

19 (b) CONFORMING AMENDMENTS.—

20 (1) The item relating to section 6111 in the table
21 of sections for subchapter B of chapter 61 is amended
22 to read as follows:

 “Sec. 6111. Disclosure of reportable transactions.”.

23 (2)(A) So much of section 6112 as precedes sub-
24 section (c) thereof is amended to read as follows:

1 **"SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANS-**
 2 **ACTIONS MUST KEEP LISTS OF ADVISEES.**

3 *"(a) IN GENERAL.—Each material advisor (as defined*
 4 *in section 6111) with respect to any reportable transaction*
 5 *(as defined in section 6707A(c)) shall maintain, in such*
 6 *manner as the Secretary may by regulations prescribe, a*
 7 *list—*

8 *"(1) identifying each person with respect to*
 9 *whom such advisor acted as such a material advisor*
 10 *with respect to such transaction, and*

11 *"(2) containing such other information as the*
 12 *Secretary may by regulations require.*

13 *This section shall apply without regard to whether a mate-*
 14 *rial advisor is required to file a return under section 6111*
 15 *with respect to such transaction."*

16 *(B) Section 6112 is amended by redesignating*
 17 *subsection (c) as subsection (b).*

18 *(C) Section 6112(b), as redesignated by subpara-*
 19 *graph (B), is amended—*

20 *(i) by inserting "written" before "request"*
 21 *in paragraph (1)(A), and*

22 *(ii) by striking "shall prescribe" in para-*
 23 *graph (2) and inserting "may prescribe".*

24 *(D) The item relating to section 6112 in the*
 25 *table of sections for subchapter B of chapter 61 is*
 26 *amended to read as follows:*

"Sec. 6112. Material advisors of reportable transactions must keep lists of advisees."

1 (3)(A) *The heading for section 6708 is amended*
2 *to read as follows:*

3 **"SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
4 **WITH RESPECT TO REPORTABLE TRANS-**
5 **ACTIONS."**

6 (B) *The item relating to section 6708 in the*
7 *table of sections for part I of subchapter B of chapter*
8 *68 is amended to read as follows:*

"Sec. 6708. Failure to maintain lists of advisees with respect to reportable transactions."

9 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
10 **OF CONFIDENTIALITY.**—*Subparagraph (A) of section*
11 *6112(b)(1), as redesignated by subsection (b)(2)(B), is*
12 *amended by adding at the end the following new flush sen-*
13 *tence:*

14 *"For purposes of this section, the identity of any per-*
15 *son on such list shall not be privileged."*

16 (d) **EFFECTIVE DATE.**—

17 (1) **IN GENERAL.**—*Except as provided in para-*
18 *graph (2), the amendments made by this section shall*
19 *apply to transactions with respect to which material*
20 *aid, assistance, or advice referred to in section*
21 *6111(b)(1)(A)(i) of the Internal Revenue Code of 1986*
22 *(as added by this section) is provided after the date*
23 *of the enactment of this Act.*

1 (2) *NO CLAIM OF CONFIDENTIALITY AGAINST DIS-*
 2 *CLOSURE.—The amendment made by subsection (c)*
 3 *shall take effect as if included in the amendments*
 4 *made by section 142 of the Deficit Reduction Act of*
 5 *1984.*

6 **SEC. 408. MODIFICATIONS TO PENALTY FOR FAILURE TO**
 7 **REGISTER TAX SHELTERS.**

8 (a) *IN GENERAL.—Section 6707 (relating to failure to*
 9 *furnish information regarding tax shelters) is amended to*
 10 *read as follows:*

11 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
 12 **ING REPORTABLE TRANSACTIONS.**

13 “(a) *IN GENERAL.—If a person who is required to file*
 14 *a return under section 6111(a) with respect to any report-*
 15 *able transaction—*

16 “(1) *fails to file such return on or before the date*
 17 *prescribed therefor, or*

18 “(2) *files false or incomplete information with*
 19 *the Secretary with respect to such transaction,*
 20 *such person shall pay a penalty with respect to such return*
 21 *in the amount determined under subsection (b).*

22 “(b) *AMOUNT OF PENALTY.—*

23 “(1) *IN GENERAL.—Except as provided in para-*
 24 *graph (2), the penalty imposed under subsection (a)*
 25 *with respect to any failure shall be \$50,000.*

1 “(2) *LISTED TRANSACTIONS.*—The penalty im-
 2 posed under subsection (a) with respect to any listed
 3 transaction shall be an amount equal to the greater
 4 of—

5 “(A) \$200,000, or

6 “(B) 50 percent of the gross income derived
 7 by such person with respect to aid, assistance, or
 8 advice which is provided with respect to the list-
 9 ed transaction before the date the return includ-
 10 ing the transaction is filed under section 6111.

11 Subparagraph (B) shall be applied by substituting
 12 ‘75 percent’ for ‘50 percent’ in the case of an inten-
 13 tional failure or act described in subsection (a).

14 “(c) *CERTAIN RULES TO APPLY.*—The provisions of
 15 section 6707A(d) shall apply to any penalty imposed under
 16 this section.

17 “(d) *REPORTABLE AND LISTED TRANSACTIONS.*—The
 18 terms ‘reportable transaction’ and ‘listed transaction’ have
 19 the respective meanings given to such terms by section
 20 6707A(c).”.

21 (b) *CLERICAL AMENDMENT.*—The item relating to sec-
 22 tion 6707 in the table of sections for part I of subchapter
 23 B of chapter 68 is amended by striking “tax shelters” and
 24 inserting “reportable transactions”.

1 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 2 *section shall apply to returns the due date for which is after*
 3 *the date of the enactment of this Act.*

4 **SEC. 409. MODIFICATION OF PENALTY FOR FAILURE TO**
 5 **MAINTAIN LISTS OF INVESTORS.**

6 (a) *IN GENERAL.*—*Subsection (a) of section 6708 is*
 7 *amended to read as follows:*

8 “(a) *IMPOSITION OF PENALTY.*—

9 “(1) *IN GENERAL.*—*If any person who is re-*
 10 *quired to maintain a list under section 6112(a) fails*
 11 *to make such list available upon written request to*
 12 *the Secretary in accordance with section*
 13 *6112(b)(1)(A) within 20 business days after the date*
 14 *of the Secretary’s request, such person shall pay a*
 15 *penalty of \$10,000 for each day of such failure after*
 16 *such 20th day.*

17 “(2) *REASONABLE CAUSE EXCEPTION.*—*No pen-*
 18 *alty shall be imposed by paragraph (1) with respect*
 19 *to the failure on any day if such failure is due to rea-*
 20 *sonable cause.”.*

21 (b) *EFFECTIVE DATE.*—*The amendment made by this*
 22 *section shall apply to requests made after the date of the*
 23 *enactment of this Act.*

1 **SEC. 410. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
 2 **CONDUCT RELATED TO TAX SHELTERS AND**
 3 **REPORTABLE TRANSACTIONS.**

4 (a) *IN GENERAL.*—Section 7408 (relating to action to
 5 enjoin promoters of abusive tax shelters, etc.) is amended
 6 by redesignating subsection (c) as subsection (d) and by
 7 striking subsections (a) and (b) and inserting the following
 8 new subsections:

9 “(a) *AUTHORITY TO SEEK INJUNCTION.*—A civil ac-
 10 tion in the name of the United States to enjoin any person
 11 from further engaging in specified conduct may be com-
 12 menced at the request of the Secretary. Any action under
 13 this section shall be brought in the district court of the
 14 United States for the district in which such person resides,
 15 has his principal place of business, or has engaged in speci-
 16 fied conduct. The court may exercise its jurisdiction over
 17 such action (as provided in section 7402(a)) separate and
 18 apart from any other action brought by the United States
 19 against such person.

20 “(b) *ADJUDICATION AND DECREE.*—In any action
 21 under subsection (a), if the court finds—

22 “(1) that the person has engaged in any specified
 23 conduct, and

24 “(2) that injunctive relief is appropriate to pre-
 25 vent recurrence of such conduct,

1 the court may enjoin such person from engaging in such
 2 conduct or in any other activity subject to penalty under
 3 this title.

4 “(c) **SPECIFIED CONDUCT.**—For purposes of this sec-
 5 tion, the term ‘specified conduct’ means any action, or fail-
 6 ure to take action, subject to penalty under section 6700,
 7 6701, 6707, or 6708.”.

8 (b) **CONFORMING AMENDMENTS.**—

9 (1) The heading for section 7408 is amended to
 10 read as follows:

11 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
 12 **LATED TO TAX SHELTERS AND REPORTABLE**
 13 **TRANSACTIONS.”.**

14 (2) The table of sections for subchapter A of
 15 chapter 67 is amended by striking the item relating
 16 to section 7408 and inserting the following new item:

“Sec. 7408. Actions to enjoin specified conduct related to tax shelters and re-
 reportable transactions.”.

17 (c) **EFFECTIVE DATE.**—The amendment made by this
 18 section shall take effect on the day after the date of the en-
 19 actment of this Act.

20 **SEC. 411. UNDERSTATEMENT OF TAXPAYER’S LIABILITY BY**
 21 **INCOME TAX RETURN PREPARER.**

22 (a) **STANDARDS CONFORMED TO TAXPAYER STAND-**
 23 **ARDS.**—Section 6694(a) (relating to understatements due to
 24 unrealistic positions) is amended—

1 (1) by striking “realistic possibility of being sus-
 2 tained on its merits” in paragraph (1) and inserting
 3 “reasonable belief that the tax treatment in such posi-
 4 tion was more likely than not the proper treatment”,

5 (2) by striking “or was frivolous” in paragraph
 6 (3) and inserting “or there was no reasonable basis
 7 for the tax treatment of such position”, and

8 (3) by striking “UNREALISTIC” in the heading
 9 and inserting “IMPROPER”.

10 (b) *AMOUNT OF PENALTY.*—Section 6694 is amend-
 11 ed—

12 (1) by striking “\$250” in subsection (a) and in-
 13 serting “\$1,000”, and

14 (2) by striking “\$1,000” in subsection (b) and
 15 inserting “\$5,000”.

16 (c) *EFFECTIVE DATE.*—The amendments made by this
 17 section shall apply to documents prepared after the date
 18 of the enactment of this Act.

19 **SEC. 412. PENALTY ON FAILURE TO REPORT INTERESTS IN**
 20 **FOREIGN FINANCIAL ACCOUNTS.**

21 (a) *IN GENERAL.*—Section 5321(a)(5) of title 31,
 22 United States Code, is amended to read as follows:

23 “(5) *FOREIGN FINANCIAL AGENCY TRANSACTION*
 24 *VIOLATION.*—

1 “(A) *PENALTY AUTHORIZED.*—*The Sec-*
2 *retary of the Treasury may impose a civil money*
3 *penalty on any person who violates, or causes*
4 *any violation of, any provision of section 5314.*

5 “(B) *AMOUNT OF PENALTY.*—

6 “(i) *IN GENERAL.*—*Except as provided*
7 *in subparagraph (C), the amount of any*
8 *civil penalty imposed under subparagraph*
9 *(A) shall not exceed \$5,000.*

10 “(ii) *REASONABLE CAUSE EXCEP-*
11 *TION.*—*No penalty shall be imposed under*
12 *subparagraph (A) with respect to any viola-*
13 *tion if—*

14 “(I) *such violation was due to*
15 *reasonable cause, and*

16 “(II) *the amount of the trans-*
17 *action or the balance in the account at*
18 *the time of the transaction was prop-*
19 *erly reported.*

20 “(C) *WILLFUL VIOLATIONS.*—*In the case of*
21 *any person willfully violating, or willfully caus-*
22 *ing any violation of, any provision of section*
23 *5314—*

1 “(i) the maximum penalty under sub-
2 paragraph (B)(i) shall be increased to the
3 greater of—

4 “(I) \$25,000, or

5 “(II) the amount (not exceeding
6 \$100,000) determined under subpara-
7 graph (D), and

8 “(ii) subparagraph (B)(ii) shall not
9 apply.

10 “(D) AMOUNT.—The amount determined
11 under this subparagraph is—

12 “(i) in the case of a violation involving
13 a transaction, the amount of the trans-
14 action, or

15 “(ii) in the case of a violation involv-
16 ing a failure to report the existence of an
17 account or any identifying information re-
18 quired to be provided with respect to an ac-
19 count, the balance in the account at the
20 time of the violation.”.

21 (b) EFFECTIVE DATE.—The amendment made by this
22 section shall apply to violations occurring after the date of
23 the enactment of this Act.

1 **SEC. 413. FRIVOLOUS TAX SUBMISSIONS.**

2 (a) *CIVIL PENALTIES.*—Section 6702 is amended to
3 read as follows:

4 **“SEC. 6702. FRIVOLOUS TAX SUBMISSIONS.**

5 **“(a) CIVIL PENALTY FOR FRIVOLOUS TAX RE-**
6 **URNS.**—A person shall pay a penalty of \$5,000 if—

7 “(1) such person files what purports to be a re-
8 turn of a tax imposed by this title but which—

9 “(A) does not contain information on which
10 the substantial correctness of the self-assessment
11 may be judged, or

12 “(B) contains information that on its face
13 indicates that the self-assessment is substantially
14 incorrect; and

15 “(2) the conduct referred to in paragraph (1)—

16 “(A) is based on a position which the Sec-
17 retary has identified as frivolous under sub-
18 section (c), or

19 “(B) reflects a desire to delay or impede the
20 administration of Federal tax laws.

21 **“(b) CIVIL PENALTY FOR SPECIFIED FRIVOLOUS SUB-**
22 **MISSIONS.**—

23 **“(1) IMPOSITION OF PENALTY.**—Except as pro-
24 vided in paragraph (3), any person who submits a
25 specified frivolous submission shall pay a penalty of
26 \$5,000.

1 “(2) *SPECIFIED FRIVOLOUS SUBMISSION.*—*For*
2 *purposes of this section—*

3 “(A) *SPECIFIED FRIVOLOUS SUBMISSION.*—
4 *The term ‘specified frivolous submission’ means*
5 *a specified submission if any portion of such*
6 *submission—*

7 “(i) *is based on a position which the*
8 *Secretary has identified as frivolous under*
9 *subsection (c), or*

10 “(ii) *reflects a desire to delay or im-*
11 *pede the administration of Federal tax*
12 *laws.*

13 “(B) *SPECIFIED SUBMISSION.*—*The term*
14 *‘specified submission’ means—*

15 “(i) *a request for a hearing under—*

16 “(I) *section 6320 (relating to no-*
17 *tice and opportunity for hearing upon*
18 *filing of notice of lien), or*

19 “(II) *section 6330 (relating to no-*
20 *tice and opportunity for hearing before*
21 *levy), and*

22 “(ii) *an application under—*

23 “(I) *section 6159 (relating to*
24 *agreements for payment of tax liability*
25 *in installments),*

1 “(II) section 7122 (relating to
2 *compromises*), or

3 “(III) section 7811 (relating to
4 *taxpayer assistance orders*).

5 “(3) *OPPORTUNITY TO WITHDRAW SUBMIS-*
6 *SION.—If the Secretary provides a person with notice*
7 *that a submission is a specified frivolous submission*
8 *and such person withdraws such submission within*
9 *30 days after such notice, the penalty imposed under*
10 *paragraph (1) shall not apply with respect to such*
11 *submission.*

12 “(c) *LISTING OF FRIVOLOUS POSITIONS.—The Sec-*
13 *retary shall prescribe (and periodically revise) a list of posi-*
14 *tions which the Secretary has identified as being frivolous*
15 *for purposes of this subsection. The Secretary shall not in-*
16 *clude in such list any position that the Secretary deter-*
17 *mines meets the requirement of section*
18 *6662(d)(2)(B)(ii)(II).*

19 “(d) *REDUCTION OF PENALTY.—The Secretary may*
20 *reduce the amount of any penalty imposed under this sec-*
21 *tion if the Secretary determines that such reduction would*
22 *promote compliance with and administration of the Federal*
23 *tax laws.*

1 “(e) *PENALTIES IN ADDITION TO OTHER PEN-*
 2 *ALTIES.—The penalties imposed by this section shall be in*
 3 *addition to any other penalty provided by law.”.*

4 (b) *TREATMENT OF FRIVOLOUS REQUESTS FOR HEAR-*
 5 *INGS BEFORE LEVY.—*

6 (1) *FRIVOLOUS REQUESTS DISREGARDED.—Sec-*
 7 *tion 6330 (relating to notice and opportunity for*
 8 *hearing before levy) is amended by adding at the end*
 9 *the following new subsection:*

10 “(g) *FRIVOLOUS REQUESTS FOR HEARING, ETC.—Not-*
 11 *withstanding any other provision of this section, if the Sec-*
 12 *retary determines that any portion of a request for a hear-*
 13 *ing under this section or section 6320 meets the requirement*
 14 *of clause (i) or (ii) of section 6702(b)(2)(A), then the Sec-*
 15 *retary may treat such portion as if it were never submitted*
 16 *and such portion shall not be subject to any further admin-*
 17 *istrative or judicial review.”.*

18 (2) *PRECLUSION FROM RAISING FRIVOLOUS*
 19 *ISSUES AT HEARING.—Section 6330(c)(4) is amend-*
 20 *ed—*

21 (A) *by striking “(A)” and inserting*
 22 *“(A)(i)”;*

23 (B) *by striking “(B)” and inserting “(ii)”;*

24 (C) *by striking the period at the end of the*
 25 *first sentence and inserting “; or”; and*

1 (D) by inserting after subparagraph (A)(ii)
2 (as so redesignated) the following:

3 “(B) the issue meets the requirement of
4 clause (i) or (ii) of section 6702(b)(2)(A).”.

5 (3) STATEMENT OF GROUNDS.—Section
6 6330(b)(1) is amended by striking “under subsection
7 (a)(3)(B)” and inserting “in writing under subsection
8 (a)(3)(B) and states the grounds for the requested
9 hearing”.

10 (c) TREATMENT OF FRIVOLOUS REQUESTS FOR HEAR-
11 INGS UPON FILING OF NOTICE OF LIEN.—Section 6320 is
12 amended—

13 (1) in subsection (b)(1), by striking “under sub-
14 section (a)(3)(B)” and inserting “in writing under
15 subsection (a)(3)(B) and states the grounds for the re-
16 quested hearing”, and

17 (2) in subsection (c), by striking “and (e)” and
18 inserting “(e), and (g)”.

19 (d) TREATMENT OF FRIVOLOUS APPLICATIONS FOR
20 OFFERS-IN-COMPROMISE AND INSTALLMENT AGREE-
21 MENTS.—Section 7122 is amended by adding at the end
22 the following new subsection:

23 “(e) FRIVOLOUS SUBMISSIONS, ETC.—Notwith-
24 standing any other provision of this section, if the Secretary
25 determines that any portion of an application for an offer-

1 in-compromise or installment agreement submitted under
 2 this section or section 6159 meets the requirement of clause
 3 (i) or (ii) of section 6702(b)(2)(A), then the Secretary may
 4 treat such portion as if it were never submitted and such
 5 portion shall not be subject to any further administrative
 6 or judicial review.”.

7 (e) CLERICAL AMENDMENT.—The table of sections for
 8 part I of subchapter B of chapter 68 is amended by striking
 9 the item relating to section 6702 and inserting the following
 10 new item:

“Sec. 6702. Frivolous tax submissions.”.

11 (f) EFFECTIVE DATE.—The amendments made by this
 12 section shall apply to submissions made and issues raised
 13 after the date on which the Secretary first prescribes a list
 14 under section 6702(c) of the Internal Revenue Code of 1986,
 15 as amended by subsection (a).

16 **SEC. 414. REGULATION OF INDIVIDUALS PRACTICING BE-**
 17 **FORE THE DEPARTMENT OF TREASURY.**

18 (a) CENSURE; IMPOSITION OF PENALTY.—

19 (1) IN GENERAL.—Section 330(b) of title 31,
 20 United States Code, is amended—

21 (A) by inserting “, or censure,” after “De-
 22 partment”, and

23 (B) by adding at the end the following new
 24 flush sentence:

1 *"The Secretary may impose a monetary penalty on any*
 2 *representative described in the preceding sentence. If the*
 3 *representative was acting on behalf of an employer or any*
 4 *firm or other entity in connection with the conduct giving*
 5 *rise to such penalty, the Secretary may impose a monetary*
 6 *penalty on such employer, firm, or entity if it knew, or*
 7 *reasonably should have known, of such conduct. Such pen-*
 8 *alty shall not exceed the gross income derived (or to be de-*
 9 *rived) from the conduct giving rise to the penalty and may*
 10 *be in addition to, or in lieu of, any suspension, disbarment,*
 11 *or censure of the representative."*

12 (2) *EFFECTIVE DATE.*—*The amendments made*
 13 *by this subsection shall apply to actions taken after*
 14 *the date of the enactment of this Act.*

15 (b) *TAX SHELTER OPINIONS, ETC.*—*Section 330 of*
 16 *such title 31 is amended by adding at the end the following*
 17 *new subsection:*

18 "*(d) Nothing in this section or in any other provision*
 19 *of law shall be construed to limit the authority of the Sec-*
 20 *retary of the Treasury to impose standards applicable to*
 21 *the rendering of written advice with respect to any entity,*
 22 *transaction plan or arrangement, or other plan or arrange-*
 23 *ment, which is of a type which the Secretary determines*
 24 *as having a potential for tax avoidance or evasion."*

1 **SEC. 415. PENALTY ON PROMOTERS OF TAX SHELTERS.**

2 (a) *PENALTY ON PROMOTING ABUSIVE TAX SHEL-*
 3 *TERS.*—Section 6700(a) is amended by adding at the end
 4 *the following new sentence: “Notwithstanding the first sen-*
 5 *tence, if an activity with respect to which a penalty im-*
 6 *posed under this subsection involves a statement described*
 7 *in paragraph (2)(A), the amount of the penalty shall be*
 8 *equal to 50 percent of the gross income derived (or to be*
 9 *derived) from such activity by the person on which the pen-*
 10 *alty is imposed.”.*

11 (b) *EFFECTIVE DATE.*—The amendment made by this
 12 section shall apply to activities after the date of the enact-
 13 ment of this Act.

14 **SEC. 416. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
 15 **FOR WHICH REQUIRED LISTED TRANS-**
 16 **ACTIONS NOT REPORTED.**

17 (a) *IN GENERAL.*—Section 6501(c) (relating to excep-
 18 tions) is amended by adding at the end the following new
 19 paragraph:

20 “(10) *LISTED TRANSACTIONS.*—If a taxpayer
 21 fails to include on any return or statement for any
 22 taxable year any information with respect to a listed
 23 transaction (as defined in section 6707A(c)(2)) which
 24 is required under section 6011 to be included with
 25 such return or statement, the time for assessment of
 26 any tax imposed by this title with respect to such

1 transaction shall not expire before the date which is
 2 1 year after the earlier of—

3 “(A) the date on which the Secretary is fur-
 4 nished the information so required; or

5 “(B) the date that a material advisor (as
 6 defined in section 6111) meets the requirements
 7 of section 6112 with respect to a request by the
 8 Secretary under section 6112(b) relating to such
 9 transaction with respect to such taxpayer.”.

10 (b) *EFFECTIVE DATE.*—The amendment made by this
 11 section shall apply to taxable years with respect to which
 12 the period for assessing a deficiency did not expire before
 13 the date of the enactment of this Act.

14 **SEC. 417. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
 15 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
 16 **CLOSED REPORTABLE AND NONECONOMIC**
 17 **SUBSTANCE TRANSACTIONS.**

18 (a) *IN GENERAL.*—Section 163 (relating to deduction
 19 for interest) is amended by redesignating subsection (m) as
 20 subsection (n) and by inserting after subsection (l) the fol-
 21 lowing new subsection:

22 “(m) *INTEREST ON UNPAID TAXES ATTRIBUTABLE TO*
 23 *NONDISCLOSED REPORTABLE TRANSACTIONS AND NON-*
 24 *ECONOMIC SUBSTANCE TRANSACTIONS.*—No deduction shall
 25 be allowed under this chapter for any interest paid or ac-

1 *crued under section 6601 on any underpayment of tax*
 2 *which is attributable to—*

3 *“(1) the portion of any reportable transaction*
 4 *understatement (as defined in section 6662A(b)) with*
 5 *respect to which the requirement of section*
 6 *6664(d)(2)(A) is not met, or*

7 *“(2) any noneconomic substance transaction un-*
 8 *derstatement (as defined in section 6662B(c)).”*

9 *(b) EFFECTIVE DATE.—The amendments made by this*
 10 *section shall apply to transactions in taxable years begin-*
 11 *ning after the date of the enactment of this Act.*

12 **SEC. 418. AUTHORIZATION OF APPROPRIATIONS FOR TAX**
 13 **LAW ENFORCEMENT.**

14 *There is authorized to be appropriated \$300,000,000*
 15 *for each fiscal year beginning after September 30, 2003, for*
 16 *the purpose of carrying out tax law enforcement to combat*
 17 *tax avoidance transactions and other tax shelters, including*
 18 *the use of offshore financial accounts to conceal taxable in-*
 19 *come.*

20 **Subtitle B—Other Corporate**
 21 **Governance Provisions**

22 **SEC. 421. AFFIRMATION OF CONSOLIDATED RETURN REGU-**
 23 **LATION AUTHORITY.**

24 *(a) IN GENERAL.—Section 1502 (relating to consoli-*
 25 *dated return regulations) is amended by adding at the end*

1 the following new sentence: "In prescribing such regula-
 2 tions, the Secretary may prescribe rules applicable to cor-
 3 porations filing consolidated returns under section 1501
 4 that are different from other provisions of this title that
 5 would apply if such corporations filed separate returns."

6 (b) **RESULT NOT OVERTURNED.**—Notwithstanding
 7 subsection (a), the Internal Revenue Code of 1986 shall be
 8 construed by treating Treasury regulation §1.1502-
 9 20(c)(1)(iii) (as in effect on January 1, 2001) as being in-
 10 applicable to the type of factual situation in 255 F.3d 1357
 11 (Fed. Cir. 2001).

12 (c) **EFFECTIVE DATE.**—The provisions of this section
 13 shall apply to taxable years beginning before, on, or after
 14 the date of the enactment of this Act.

15 **SEC. 422. SIGNING OF CORPORATE TAX RETURNS BY CHIEF**
 16 **EXECUTIVE OFFICER.**

17 (a) **IN GENERAL.**—Section 6062 (relating to signing
 18 of corporation returns) is amended by inserting after the
 19 first sentence the following new sentences: "The return of
 20 a corporation with respect to income shall also include a
 21 declaration signed by the chief executive officer of such cor-
 22 poration (or other such officer of the corporation as the Sec-
 23 retary may designate if the corporation does not have a
 24 chief executive officer), under penalties of perjury, that the
 25 chief executive officer ensures that such return complies

1 with this title and that the chief executive officer was pro-
 2 vided reasonable assurance of the accuracy of all material
 3 aspects of such return. The preceding sentence shall not
 4 apply to any return of a regulated investment company
 5 (within the meaning of section 851).”.

6 (b) *EFFECTIVE DATE.*—The amendment made by this
 7 section shall apply to returns filed after the date of the en-
 8 actment of this Act.

9 **SEC. 423. DENIAL OF DEDUCTION FOR CERTAIN FINES, PEN-**
 10 **ALTIES, AND OTHER AMOUNTS.**

11 (a) *IN GENERAL.*—Subsection (f) of section 162 (relat-
 12 ing to trade or business expenses) is amended to read as
 13 follows:

14 “(f) *FINES, PENALTIES, AND OTHER AMOUNTS.*—

15 “(1) *IN GENERAL.*—Except as provided in para-
 16 graph (2), no deduction otherwise allowable shall be
 17 allowed under this chapter for any amount paid or
 18 incurred (whether by suit, agreement, or otherwise)
 19 to, or at the direction of, a government or entity de-
 20 scribed in paragraph (4) in relation to the violation
 21 of any law or the investigation or inquiry by such
 22 government or entity into the potential violation of
 23 any law.

24 “(2) *EXCEPTION FOR AMOUNTS CONSTITUTING*
 25 *RESTITUTION.*—Paragraph (1) shall not apply to any

1 *amount which the taxpayer establishes constitutes res-*
2 *titution for damage or harm caused by the violation*
3 *of any law or the potential violation of any law. This*
4 *paragraph shall not apply to any amount paid or in-*
5 *curring as reimbursement to the government or entity*
6 *for the costs of any investigation or litigation.*

7 “(3) *EXCEPTION FOR AMOUNTS PAID OR IN-*
8 *CURRED AS THE RESULT OF CERTAIN COURT OR-*
9 *ERS.—Paragraph (1) shall not apply to any*
10 *amount paid or incurred by order of a court in a suit*
11 *in which no government or entity described in para-*
12 *graph (4) is a party.*

13 “(4) *CERTAIN NONGOVERNMENTAL REGULATORY*
14 *ENTITIES.—An entity is described in this paragraph*
15 *if it is—*

16 “(A) *a nongovernmental entity which exer-*
17 *cises self-regulatory powers (including imposing*
18 *sanctions) in connection with a qualified board*
19 *or exchange (as defined in section 1256(g)(7)), or*

20 “(B) *to the extent provided in regulations,*
21 *a nongovernmental entity which exercises self-*
22 *regulatory powers (including imposing sanc-*
23 *tions) as part of performing an essential govern-*
24 *mental function.”.*

1 (b) *EFFECTIVE DATE.*—*The amendment made by this*
 2 *section shall apply to amounts paid or incurred after April*
 3 *27, 2003, except that such amendment shall not apply to*
 4 *amounts paid or incurred under any binding order or*
 5 *agreement entered into on or before April 27, 2003. Such*
 6 *exception shall not apply to an order or agreement requir-*
 7 *ing court approval unless the approval was obtained on or*
 8 *before April 27, 2003.*

9 **SEC. 424. DISALLOWANCE OF DEDUCTION FOR PUNITIVE**
 10 **DAMAGES.**

11 (a) *DISALLOWANCE OF DEDUCTION.*—

12 (1) *IN GENERAL.*—*Section 162(g) (relating to*
 13 *treble damage payments under the antitrust laws) is*
 14 *amended by adding at the end the following new*
 15 *paragraph:*

16 “(2) *PUNITIVE DAMAGES.*—*No deduction shall be*
 17 *allowed under this chapter for any amount paid or*
 18 *incurred for punitive damages in connection with*
 19 *any judgment in, or settlement of, any action. This*
 20 *paragraph shall not apply to punitive damages de-*
 21 *scribed in section 104(c).”*

22 (2) *CONFORMING AMENDMENTS.*—

23 (A) *Section 162(g) is amended—*

24 (i) *by striking “If” and inserting:*

25 “(1) *TREBLE DAMAGES.*—*If*, and

1 (ii) by redesignating paragraphs (1)
2 and (2) as subparagraphs (A) and (B), re-
3 spectively.

4 (B) The heading for section 162(g) is
5 amended by inserting "OR PUNITIVE DAMAGES"
6 after "LAWS".

7 (b) *INCLUSION IN INCOME OF PUNITIVE DAMAGES*
8 *PAID BY INSURER OR OTHERWISE.—*

9 (1) *IN GENERAL.—*Part II of subchapter B of
10 chapter 1 (relating to items specifically included in
11 gross income) is amended by adding at the end the
12 following new section:

13 *"SEC. 91. PUNITIVE DAMAGES COMPENSATED BY INSUR-*
14 *ANCE OR OTHERWISE.*

15 "Gross income shall include any amount paid to or
16 on behalf of a taxpayer as insurance or otherwise by reason
17 of the taxpayer's liability (or agreement) to pay punitive
18 damages."

19 (2) *REPORTING REQUIREMENTS.—*Section 6041
20 (relating to information at source) is amended by
21 adding at the end the following new subsection:

22 "(f) *SECTION TO APPLY TO PUNITIVE DAMAGES COM-*
23 *PENSATION.—*This section shall apply to payments by a
24 person to or on behalf of another person as insurance or

1 otherwise by reason of the other person's liability (or agree-
2 ment) to pay punitive damages.”.

3 (3) *CONFORMING AMENDMENT.*—The table of sec-
4 tions for part II of subchapter B of chapter 1 is
5 amended by adding at the end the following new item:

“Sec. 91. Punitive damages compensated by insurance or otherwise.”.

6 (c) *EFFECTIVE DATE.*—The amendments made by this
7 section shall apply to damages paid or incurred on or after
8 the date of the enactment of this Act.

9 **SEC. 425. INCREASE IN CRIMINAL MONETARY PENALTY LIM-**
10 **ITATION FOR THE UNDERPAYMENT OR OVER-**
11 **PAYMENT OF TAX DUE TO FRAUD.**

12 (a) *IN GENERAL.*—Section 7206 (relating to fraud and
13 false statements) is amended—

14 (1) by striking “Any person who—” and insert-
15 ing “(a) *IN GENERAL.*—Any person who—”, and

16 (2) by adding at the end the following new sub-
17 section:

18 “(b) *INCREASE IN MONETARY LIMITATION FOR UN-*
19 *DERPAYMENT OR OVERPAYMENT OF TAX DUE TO FRAUD.*—
20 If any portion of any underpayment (as defined in section
21 6664(a)) or overpayment (as defined in section 6401(a)) of
22 tax required to be shown on a return is attributable to
23 fraudulent action described in subsection (a), the applicable
24 dollar amount under subsection (a) shall in no event be less
25 than an amount equal to such portion. A rule similar to

1 *the rule under section 6663(b) shall apply for purposes of*
 2 *determining the portion so attributable.”*

3 *(b) INCREASE IN PENALTIES.—*

4 *(1) ATTEMPT TO EVADE OR DEFEAT TAX.—Section*
 5 *7201 is amended—*

6 *(A) by striking “\$100,000” and inserting*
 7 *“\$250,000”,*

8 *(B) by striking “\$500,000” and inserting*
 9 *“\$1,000,000”, and*

10 *(C) by striking “5 years” and inserting “10*
 11 *years”.*

12 *(2) WILLFUL FAILURE TO FILE RETURN, SUPPLY*
 13 *INFORMATION, OR PAY TAX.—Section 7203 is amend-*
 14 *ed—*

15 *(A) in the first sentence—*

16 *(i) by striking “misdemeanor” and in-*
 17 *serting “felony”, and*

18 *(ii) by striking “1 year” and inserting*
 19 *“10 years”, and*

20 *(B) by striking the third sentence.*

21 *(3) FRAUD AND FALSE STATEMENTS.—Section*
 22 *7206(a) (as redesignated by subsection (a)) is amend-*
 23 *ed—*

24 *(A) by striking “\$100,000” and inserting*
 25 *“\$250,000”,*

1 (B) by striking “\$500,000” and inserting
2 “\$1,000,000”, and

3 (C) by striking “3 years” and inserting “5
4 years”.

5 (c) *EFFECTIVE DATE.*—The amendments made by this
6 section shall apply to underpayments and overpayments at-
7 tributable to actions occurring after the date of the enact-
8 ment of this Act.

9 ***Subtitle C—Enron-Related Tax***
10 ***Shelter Provisions***

11 ***SEC. 431. LIMITATION ON TRANSFER OR IMPORTATION OF***
12 ***BUILT-IN LOSSES.***

13 (a) *IN GENERAL.*—Section 362 (relating to basis to
14 corporations) is amended by adding at the end the following
15 new subsection:

16 “(e) *LIMITATIONS ON BUILT-IN LOSSES.*—

17 “(1) *LIMITATION ON IMPORTATION OF BUILT-IN*
18 *LOSSES.*—

19 “(A) *IN GENERAL.*—If in any transaction
20 described in subsection (a) or (b) there would
21 (but for this subsection) be an importation of a
22 net built-in loss, the basis of each property de-
23 scribed in subparagraph (B) which is acquired
24 in such transaction shall (notwithstanding sub-

1 sections (a) and (b)) be its fair market value im-
2 mediately after such transaction.

3 “(B) *PROPERTY DESCRIBED.*—For purposes
4 of subparagraph (A), property is described in
5 this subparagraph if—

6 “(i) gain or loss with respect to such
7 property is not subject to tax under this
8 subtitle in the hands of the transferor imme-
9 diately before the transfer, and

10 “(ii) gain or loss with respect to such
11 property is subject to such tax in the hands
12 of the transferee immediately after such
13 transfer.

14 In any case in which the transferor is a partner-
15 ship, the preceding sentence shall be applied by
16 treating each partner in such partnership as
17 holding such partner's proportionate share of the
18 property of such partnership.

19 “(C) *IMPORTATION OF NET BUILT-IN*
20 *LOSS.*—For purposes of subparagraph (A), there
21 is an importation of a net built-in loss in a
22 transaction if the transferee's aggregate adjusted
23 bases of property described in subparagraph (B)
24 which is transferred in such transaction would
25 (but for this paragraph) exceed the fair market

1 *value of such property immediately after such*
2 *transaction.”.*

3 *“(2) LIMITATION ON TRANSFER OF BUILT-IN*
4 *LOSSES IN SECTION 351 TRANSACTIONS.—*

5 *“(A) IN GENERAL.—If—*

6 *“(i) property is transferred by a trans-*
7 *feror in any transaction which is described*
8 *in subsection (a) and which is not described*
9 *in paragraph (1) of this subsection, and*

10 *“(ii) the transferee’s aggregate adjusted*
11 *bases of such property so transferred would*
12 *(but for this paragraph) exceed the fair*
13 *market value of such property immediately*
14 *after such transaction,*
15 *then, notwithstanding subsection (a), the trans-*
16 *feree’s aggregate adjusted bases of the property so*
17 *transferred shall not exceed the fair market value*
18 *of such property immediately after such trans-*
19 *action.*

20 *“(B) ALLOCATION OF BASIS REDUCTION.—*

21 *The aggregate reduction in basis by reason of*
22 *subparagraph (A) shall be allocated among the*
23 *property so transferred in proportion to their re-*
24 *spective built-in losses immediately before the*
25 *transaction.*

1 “(C) *EXCEPTION FOR TRANSFERS WITHIN*
 2 *AFFILIATED GROUP.*—Subparagraph (A) shall
 3 not apply to any transaction if the transferor
 4 owns stock in the transferee meeting the require-
 5 ments of section 1504(a)(2). In the case of prop-
 6 erty to which subparagraph (A) does not apply
 7 by reason of the preceding sentence, the trans-
 8 feror’s basis in the stock received for such prop-
 9 erty shall not exceed its fair market value imme-
 10 diately after the transfer.”.

11 (b) *COMPARABLE TREATMENT WHERE LIQUIDA-*
 12 *TION.*—Paragraph (1) of section 334(b) (relating to liquida-
 13 tion of subsidiary) is amended to read as follows:

14 “(1) *IN GENERAL.*—If property is received by a
 15 corporate distributee in a distribution in a complete
 16 liquidation to which section 332 applies (or in a
 17 transfer described in section 337(b)(1)), the basis of
 18 such property in the hands of such distributee shall
 19 be the same as it would be in the hands of the trans-
 20 feror; except that the basis of such property in the
 21 hands of such distributee shall be the fair market
 22 value of the property at the time of the distribution—

23 “(A) in any case in which gain or loss is
 24 recognized by the liquidating corporation with
 25 respect to such property, or

1 “(B) in any case in which the liquidating
 2 corporation is a foreign corporation, the cor-
 3 porate distributee is a domestic corporation, and
 4 the corporate distributee’s aggregate adjusted
 5 bases of property described in section
 6 362(e)(1)(B) which is distributed in such liq-
 7 uidation would (but for this subparagraph) ex-
 8 ceed the fair market value of such property im-
 9 mediately after such liquidation.”.

10 (c) *EFFECTIVE DATE.*—The amendments made by this
 11 section shall apply to transactions after February 13, 2003.

12 **SEC. 432. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
 13 **STOCK HELD BY PARTNERSHIP IN COR-**
 14 **PORATE PARTNER.**

15 (a) *IN GENERAL.*—Section 755 is amended by adding
 16 at the end the following new subsection:

17 “(c) *NO ALLOCATION OF BASIS DECREASE TO STOCK*
 18 *OF CORPORATE PARTNER.*—In making an allocation under
 19 subsection (a) of any decrease in the adjusted basis of part-
 20 nership property under section 734(b)—

21 “(1) no allocation may be made to stock in a
 22 corporation (or any person which is related (within
 23 the meaning of section 267(b) or 707(b)(1)) to such
 24 corporation) which is a partner in the partnership,
 25 and

1 “(2) any amount not allocable to stock by reason
2 of paragraph (1) shall be allocated under subsection
3 (a) to other partnership property in such manner as
4 the Secretary may prescribe.

5 Gain shall be recognized to the partnership to the extent
6 that the amount required to be allocated under paragraph
7 (2) to other partnership property exceeds the aggregate ad-
8 justed basis of such other property immediately before the
9 allocation required by paragraph (2).”.

10 (b) *EFFECTIVE DATE.*—The amendment made by this
11 section shall apply to distributions after February 13, 2003.

12 **SEC. 433. REPEAL OF SPECIAL RULES FOR FASITS.**

13 (a) *IN GENERAL.*—Part V of subchapter M of chapter
14 1 (relating to financial asset securitization investment
15 trusts) is hereby repealed.

16 (b) *CONFORMING AMENDMENTS.*—

17 (1) Paragraph (6) of section 56(g) is amended by
18 striking “REMIC, or FASIT” and inserting “or
19 REMIC”.

20 (2) Clause (ii) of section 382(l)(4)(B) is amended
21 by striking “a REMIC to which part IV of subchapter
22 M applies, or a FASIT to which part V of subchapter
23 M applies,” and inserting “or a REMIC to which
24 part IV of subchapter M applies,”.

1 (3) Paragraph (1) of section 582(c) is amended
2 by striking “, and any regular interest in a FASIT,”.

3 (4) Subparagraph (E) of section 856(c)(5) is
4 amended by striking the last sentence.

5 (5)(A) Section 860G(a)(1) is amended by adding
6 at the end the following new sentence: “An interest
7 shall not fail to qualify as a regular interest solely be-
8 cause the specified principal amount of the regular
9 interest (or the amount of interest accrued on the reg-
10 ular interest) can be reduced as a result of the non-
11 occurrence of 1 or more contingent payments with re-
12 spect to any reverse mortgage loan held by the
13 REMIC if, on the startup day for the REMIC, the
14 sponsor reasonably believes that all principal and in-
15 terest due under the regular interest will be paid at
16 or prior to the liquidation of the REMIC.”.

17 (B) The last sentence of section 860G(a)(3) is
18 amended by inserting “, and any reverse mortgage
19 loan (and each balance increase on such loan meeting
20 the requirements of subparagraph (A)(iii)) shall be
21 treated as an obligation secured by an interest in real
22 property” before the period at the end.

23 (6) Paragraph (3) of section 860G(a) is amended
24 by adding “and” at the end of subparagraph (B), by

1 striking “, and” at the end of subparagraph (C) and
 2 inserting a period, and by striking subparagraph (D).

3 (7) Section 860G(a)(3), as amended by para-
 4 graph (6), is amended by adding at the end the fol-
 5 lowing new sentence: “For purposes of subparagraph
 6 (A), if more than 50 percent of the obligations trans-
 7 ferred to, or purchased by, the REMIC are originated
 8 by the United States or any State (or any political
 9 subdivision, agency, or instrumentality of the United
 10 States or any State) and are principally secured by
 11 an interest in real property, then each obligation
 12 transferred to, or purchased by, the REMIC shall be
 13 treated as secured by an interest in real property.”.

14 (8)(A) Section 860G(a)(3)(A) is amended by
 15 striking “or” at the end of clause (i), by inserting
 16 “or” at the end of clause (ii), and by inserting after
 17 clause (ii) the following new clause:

18 “(iii) represents an increase in the
 19 principal amount under the original terms
 20 of an obligation described in clause (i) or
 21 (ii) if such increase—

22 “(I) is attributable to an advance
 23 made to the obligor pursuant to the
 24 original terms of the obligation,

1 “(II) occurs after the startup day,
2 and

3 “(III) is purchased by the REMIC
4 pursuant to a fixed price contract in
5 effect on the startup day.”.

6 (B) Section 860G(a)(7)(B) is amended to read as
7 follows:

8 “(B) QUALIFIED RESERVE FUND.—For pur-
9 poses of subparagraph (A), the term ‘qualified
10 reserve fund’ means any reasonably required re-
11 serve to—

12 “(i) provide for full payment of ex-
13 penses of the REMIC or amounts due on
14 regular interests in the event of defaults on
15 qualified mortgages or lower than expected
16 returns on cash flow investments, or

17 “(ii) provide a source of funds for the
18 purchase of obligations described in clause
19 (ii) or (iii) of paragraph (3)(A).

20 The aggregate fair market value of the assets held
21 in any such reserve shall not exceed 50 percent
22 of the aggregate fair market value of all of the
23 assets of the REMIC on the startup day, and the
24 amount of any such reserve shall be promptly
25 and appropriately reduced to the extent the

1 amount held in such reserve is no longer reason-
 2 ably required for purposes specified in clause (i)
 3 or (ii) of paragraph (3)(A).”.

4 (9) Subparagraph (C) of section 1202(e)(4) is
 5 amended by striking “REMIC, or FASIT” and in-
 6 serting “or REMIC”.

7 (10) Section 1272(a)(6)(B) is amended by add-
 8 ing at the end the following new flush sentence:

9 “For purposes of clause (iii), the Secretary shall
 10 prescribe regulations permitting the use of a cur-
 11 rent prepayment assumption, determined as of
 12 the close of the accrual period (or such other time
 13 as the Secretary may prescribe during the tax-
 14 able year in which the accrual period ends).”.

15 (11) Subparagraph (C) of section 7701(a)(19) is
 16 amended by adding “and” at the end of clause (ix),
 17 by striking “, and” at the end of clause (x) and in-
 18 serting a period, and by striking clause (xi).

19 (12) The table of parts for subchapter M of chap-
 20 ter 1 is amended by striking the item relating to part
 21 V.

22 (c) *EFFECTIVE DATE.*—

23 (1) *IN GENERAL.*—Except as provided in para-
 24 graph (2), the amendments made by this section shall
 25 take effect on February 14, 2003.

1 (2) *EXCEPTION FOR EXISTING FASITS.*—

2 (A) *IN GENERAL.*—Paragraph (1) shall not
3 apply to any FASIT in existence on the date of
4 the enactment of this Act to the extent that reg-
5 ular interests issued by the FASIT before such
6 date continue to remain outstanding in accord-
7 ance with the original terms of issuance.

8 (B) *TRANSFER OF ADDITIONAL ASSETS NOT*
9 *PERMITTED.*—Except as provided in regulations
10 prescribed by the Secretary of the Treasury or
11 the Secretary's delegate, subparagraph (A) shall
12 cease to apply as of the earliest date after the
13 date of the enactment of this Act that any prop-
14 erty is transferred to the FASIT.

15 **SEC. 434. EXPANDED DISALLOWANCE OF DEDUCTION FOR**
16 **INTEREST ON CONVERTIBLE DEBT.**

17 (a) *IN GENERAL.*—Paragraph (2) of section 163(l) is
18 amended by striking “or a related party” and inserting “or
19 equity held by the issuer (or any related party) in any other
20 person”.

21 (b) *CAPITALIZATION ALLOWED WITH RESPECT TO EQ-*
22 *UITY OF PERSONS OTHER THAN ISSUER AND RELATED*
23 *PARTIES.*—Section 163(l) is amended by redesignating
24 paragraphs (4) and (5) as paragraphs (5) and (6) and by
25 inserting after paragraph (3) the following new paragraph:

1 “(2) *INVERTED DOMESTIC CORPORATION.*—For
2 purposes of this section, a foreign incorporated entity
3 shall be treated as an inverted domestic corporation
4 if, pursuant to a plan (or a series of related trans-
5 actions)—

6 “(A) *the entity completes after March 20,*
7 2002, the direct or indirect acquisition of sub-
8 stantially all of the properties held directly or
9 indirectly by a domestic corporation or substan-
10 tially all of the properties constituting a trade or
11 business of a domestic partnership,

12 “(B) *after the acquisition at least 80 per-*
13 cent of the stock (by vote or value) of the entity
14 is held—

15 “(i) *in the case of an acquisition with*
16 respect to a domestic corporation, by former
17 shareholders of the domestic corporation by
18 reason of holding stock in the domestic cor-
19 poration, or

20 “(ii) *in the case of an acquisition with*
21 respect to a domestic partnership, by former
22 partners of the domestic partnership by rea-
23 son of holding a capital or profits interest
24 in the domestic partnership, and

1 “(C) the expanded affiliated group which
 2 after the acquisition includes the entity does not
 3 have substantial business activities in the foreign
 4 country in which or under the law of which the
 5 entity is created or organized when compared to
 6 the total business activities of such expanded af-
 7 filiated group.

8 Except as provided in regulations, an acquisition of
 9 properties of a domestic corporation shall not be
 10 treated as described in subparagraph (A) if none of
 11 the corporation’s stock was readily tradeable on an es-
 12 tablished securities market at any time during the 4-
 13 year period ending on the date of the acquisition.

14 “(b) PRESERVATION OF DOMESTIC TAX BASE IN CER-
 15 TAIN INVERSION TRANSACTIONS TO WHICH SUBSECTION
 16 (a) DOES NOT APPLY.—

17 “(1) IN GENERAL.—If a foreign incorporated en-
 18 tity would be treated as an inverted domestic corpora-
 19 tion with respect to an acquired entity if either—

20 “(A) subsection (a)(2)(A) were applied by
 21 substituting ‘after December 31, 1996, and on or
 22 before March 20, 2002’ for ‘after March 20, 2002’
 23 and subsection (a)(2)(B) were applied by sub-
 24 stituting ‘more than 50 percent’ for ‘at least 80
 25 percent’, or

1 “(B) subsection (a)(2)(B) were applied by
2 substituting ‘more than 50 percent’ for ‘at least
3 80 percent’,

4 then the rules of subsection (c) shall apply to any in-
5 version gain of the acquired entity during the appli-
6 cable period and the rules of subsection (d) shall
7 apply to any related party transaction of the ac-
8 quired entity during the applicable period. This sub-
9 section shall not apply for any taxable year if sub-
10 section (a) applies to such foreign incorporated entity
11 for such taxable year.

12 “(2) ACQUIRED ENTITY.—For purposes of this
13 section—

14 “(A) IN GENERAL.—The term ‘acquired en-
15 tity’ means the domestic corporation or partner-
16 ship substantially all of the properties of which
17 are directly or indirectly acquired in an acquisi-
18 tion described in subsection (a)(2)(A) to which
19 this subsection applies.

20 “(B) AGGREGATION RULES.—Any domestic
21 person bearing a relationship described in sec-
22 tion 267(b) or 707(b) to an acquired entity shall
23 be treated as an acquired entity with respect to
24 the acquisition described in subparagraph (A).

1 “(3) *APPLICABLE PERIOD.*—*For purposes of this*
2 *section—*

3 “(A) *IN GENERAL.*—*The term ‘applicable*
4 *period’ means the period—*

5 “(i) *beginning on the first date prop-*
6 *erties are acquired as part of the acquisi-*
7 *tion described in subsection (a)(2)(A) to*
8 *which this subsection applies, and*

9 “(ii) *ending on the date which is 10*
10 *years after the last date properties are ac-*
11 *quired as part of such acquisition.*

12 “(B) *SPECIAL RULE FOR INVERSIONS OC-*
13 *CURRING BEFORE MARCH 21, 2002.*—*In the case*
14 *of any acquired entity to which paragraph*
15 *(1)(A) applies, the applicable period shall be the*
16 *10-year period beginning on January 1, 2003.*

17 “(c) *TAX ON INVERSION GAINS MAY NOT BE OFF-*
18 *SET.*—*If subsection (b) applies—*

19 “(1) *IN GENERAL.*—*The taxable income of an ac-*
20 *quired entity (or any expanded affiliated group which*
21 *includes such entity) for any taxable year which in-*
22 *cludes any portion of the applicable period shall in*
23 *no event be less than the inversion gain of the entity*
24 *for the taxable year.*

1 “(2) CREDITS NOT ALLOWED AGAINST TAX ON IN-
2 VERSION GAIN.—Credits shall be allowed against the
3 tax imposed by this chapter on an acquired entity for
4 any taxable year described in paragraph (1) only to
5 the extent such tax exceeds the product of—

6 “(A) the amount of the inversion gain for
7 the taxable year, and

8 “(B) the highest rate of tax specified in sec-
9 tion 11(b)(1).

10 For purposes of determining the credit allowed by sec-
11 tion 901 inversion gain shall be treated as from
12 sources within the United States.

13 “(3) SPECIAL RULES FOR PARTNERSHIPS.—In
14 the case of an acquired entity which is a partner-
15 ship—

16 “(A) the limitations of this subsection shall
17 apply at the partner rather than the partnership
18 level,

19 “(B) the inversion gain of any partner for
20 any taxable year shall be equal to the sum of—

21 “(i) the partner’s distributive share of
22 inversion gain of the partnership for such
23 taxable year, plus

24 “(ii) income or gain required to be rec-
25 ognized for the taxable year by the partner

1 under section 367(a), 741, or 1001, or
 2 under any other provision of chapter 1, by
 3 reason of the transfer during the applicable
 4 period of any partnership interest of the
 5 partner in such partnership to the foreign
 6 incorporated entity, and

7 “(C) the highest rate of tax specified in the
 8 rate schedule applicable to the partner under
 9 chapter 1 shall be substituted for the rate of tax
 10 under paragraph (2)(B).

11 “(4) *INVERSION GAIN.*—For purposes of this sec-
 12 tion, the term ‘inversion gain’ means any income or
 13 gain required to be recognized under section 304,
 14 311(b), 367, 1001, or 1248, or under any other provi-
 15 sion of chapter 1, by reason of the transfer during the
 16 applicable period of stock or other properties by an
 17 acquired entity—

18 “(A) as part of the acquisition described in
 19 subsection (a)(2)(A) to which subsection (b) ap-
 20 plies, or

21 “(B) after such acquisition to a foreign re-
 22 lated person.

23 The Secretary may provide that income or gain from
 24 the sale of inventories or other transactions in the or-
 25 dinary course of a trade or business shall not be treat-

1 *ed as inversion gain under subparagraph (B) to the*
 2 *extent the Secretary determines such treatment would*
 3 *not be inconsistent with the purposes of this section.*

4 *“(5) COORDINATION WITH SECTION 172 AND MIN-*
 5 *IMUM TAX.—Rules similar to the rules of paragraphs*
 6 *(3) and (4) of section 860E(a) shall apply for pur-*
 7 *poses of this section.*

8 *“(6) STATUTE OF LIMITATIONS.—*

9 *“(A) IN GENERAL.—The statutory period*
 10 *for the assessment of any deficiency attributable*
 11 *to the inversion gain of any taxpayer for any*
 12 *pre-inversion year shall not expire before the ex-*
 13 *piration of 3 years from the date the Secretary*
 14 *is notified by the taxpayer (in such manner as*
 15 *the Secretary may prescribe) of the acquisition*
 16 *described in subsection (a)(2)(A) to which such*
 17 *gain relates and such deficiency may be assessed*
 18 *before the expiration of such 3-year period not-*
 19 *withstanding the provisions of any other law or*
 20 *rule of law which would otherwise prevent such*
 21 *assessment.*

22 *“(B) PRE-INVERSION YEAR.—For purposes*
 23 *of subparagraph (A), the term ‘pre-inversion*
 24 *year’ means any taxable year if—*

1 “(i) any portion of the applicable pe-
2 riod is included in such taxable year, and

3 “(ii) such year ends before the taxable
4 year in which the acquisition described in
5 subsection (a)(2)(A) is completed.

6 “(d) *SPECIAL RULES APPLICABLE TO ACQUIRED EN-*
7 *TITIES TO WHICH SUBSECTION (b) APPLIES.—*

8 “(1) *INCREASES IN ACCURACY-RELATED PEN-*
9 *ALTIES.—In the case of any underpayment of tax of*
10 *an acquired entity to which subsection (b) applies—*

11 “(A) section 6662(a) shall be applied with
12 respect to such underpayment by substituting ‘30
13 percent’ for ‘20 percent’, and

14 “(B) if such underpayment is attributable
15 to one or more gross valuation understatements,
16 the increase in the rate of penalty under section
17 6662(h) shall be to 50 percent rather than 40
18 percent.

19 “(2) *MODIFICATIONS OF LIMITATION ON INTER-*
20 *EST DEDUCTION.—In the case of an acquired entity*
21 *to which subsection (b) applies, section 163(j) shall be*
22 *applied—*

23 “(A) without regard to paragraph (2)(A)(ii)
24 thereof, and

1 “(B) by substituting ‘25 percent’ for ‘50
2 percent’ each place it appears in paragraph
3 (2)(B) thereof.

4 “(e) OTHER DEFINITIONS AND SPECIAL RULES.—For
5 purposes of this section—

6 “(1) RULES FOR APPLICATION OF SUBSECTION
7 (a)(2).—In applying subsection (a)(2) for purposes of
8 subsections (a) and (b), the following rules shall
9 apply:

10 “(A) CERTAIN STOCK DISREGARDED.—
11 There shall not be taken into account in deter-
12 mining ownership for purposes of subsection
13 (a)(2)(B)—

14 “(i) stock held by members of the ex-
15 panded affiliated group which includes the
16 foreign incorporated entity, or

17 “(ii) stock of such entity which is sold
18 in a public offering or private placement re-
19 lated to the acquisition described in sub-
20 section (a)(2)(A).

21 “(B) PLAN DEEMED IN CERTAIN CASES.—If
22 a foreign incorporated entity acquires directly or
23 indirectly substantially all of the properties of a
24 domestic corporation or partnership during the
25 4-year period beginning on the date which is 2

1 years before the ownership requirements of sub-
 2 section (a)(2)(B) are met with respect to such do-
 3 mestic corporation or partnership, such actions
 4 shall be treated as pursuant to a plan.

5 “(C) CERTAIN TRANSFERS DISREGARDED.—
 6 The transfer of properties or liabilities (includ-
 7 ing by contribution or distribution) shall be dis-
 8 regarded if such transfers are part of a plan a
 9 principal purpose of which is to avoid the pur-
 10 poses of this section.

11 “(D) SPECIAL RULE FOR RELATED PART-
 12 NERSHIPS.—For purposes of applying subsection
 13 (a)(2) to the acquisition of a domestic partner-
 14 ship, except as provided in regulations, all part-
 15 nerships which are under common control (with-
 16 in the meaning of section 482) shall be treated
 17 as 1 partnership.

18 “(E) TREATMENT OF CERTAIN RIGHTS.—
 19 The Secretary shall prescribe such regulations as
 20 may be necessary—

21 “(i) to treat warrants, options, con-
 22 tracts to acquire stock, convertible debt in-
 23 struments, and other similar interests as
 24 stock, and

25 “(ii) to treat stock as not stock.

1 “(2) *EXPANDED AFFILIATED GROUP.*—The term
2 ‘expanded affiliated group’ means an affiliated group
3 as defined in section 1504(a) but without regard to
4 section 1504(b)(3), except that section 1504(a) shall
5 be applied by substituting ‘more than 50 percent’ for
6 ‘at least 80 percent’ each place it appears.

7 “(3) *FOREIGN INCORPORATED ENTITY.*—The
8 term ‘foreign incorporated entity’ means any entity
9 which is, or but for subsection (a)(1) would be, treated
10 as a foreign corporation for purposes of this title.

11 “(4) *FOREIGN RELATED PERSON.*—The term ‘for-
12 eign related person’ means, with respect to any ac-
13 quired entity, a foreign person which—

14 “(A) bears a relationship to such entity de-
15 scribed in section 267(b) or 707(b), or

16 “(B) is under the same common control
17 (within the meaning of section 482) as such enti-
18 ty.

19 “(5) *SUBSEQUENT ACQUISITIONS BY UNRELATED*
20 *DOMESTIC CORPORATIONS.*—

21 “(A) *IN GENERAL.*—Subject to such condi-
22 tions, limitations, and exceptions as the Sec-
23 retary may prescribe, if, after an acquisition de-
24 scribed in subsection (a)(2)(A) to which sub-
25 section (b) applies, a domestic corporation stock

1 of which is traded on an established securities
 2 market acquires directly or indirectly any prop-
 3 erties of one or more acquired entities in a
 4 transaction with respect to which the require-
 5 ments of subparagraph (B) are met, this section
 6 shall cease to apply to any such acquired entity
 7 with respect to which such requirements are met.

8 “(B) REQUIREMENTS.—The requirements of
 9 the subparagraph are met with respect to a
 10 transaction involving any acquisition described
 11 in subparagraph (A) if—

12 “(i) before such transaction the domes-
 13 tic corporation did not have a relationship
 14 described in section 267(b) or 707(b), and
 15 was not under common control (within the
 16 meaning of section 482), with the acquired
 17 entity, or any member of an expanded af-
 18 filiated group including such entity, and

19 “(ii) after such transaction, such ac-
 20 quired entity—

21 “(I) is a member of the same ex-
 22 panded affiliated group which includes
 23 the domestic corporation or has such a
 24 relationship or is under such common

1 control with any member of such
2 group, and

3 “(II) is not a member of, and does
4 not have such a relationship and is not
5 under such common control with any
6 member of, the expanded affiliated
7 group which before such acquisition in-
8 cluded such entity.

9 “(f) *REGULATIONS.*—The Secretary shall provide such
10 regulations as are necessary to carry out this section, in-
11 cluding regulations providing for such adjustments to the
12 application of this section as are necessary to prevent the
13 avoidance of the purposes of this section, including the
14 avoidance of such purposes through—

15 “(1) the use of related persons, pass-thru or other
16 noncorporate entities, or other intermediaries, or

17 “(2) transactions designed to have persons cease
18 to be (or not become) members of expanded affiliated
19 groups or related persons.”.

20 (b) *INFORMATION REPORTING.*—The Secretary of the
21 Treasury shall exercise the Secretary’s authority under the
22 Internal Revenue Code of 1986 to require entities involved
23 in transactions to which section 7874 of such Code (as
24 added by subsection (a)) applies to report to the Secretary,
25 shareholders, partners, and such other persons as the Sec-

1 *retary may prescribe such information as is necessary to*
 2 *ensure the proper tax treatment of such transactions.*

3 (c) *CONFORMING AMENDMENT.—The table of sections*
 4 *for subchapter C of chapter 80 is amended by adding at*
 5 *the end the following new item:*

“Sec. 7874. Rules relating to inverted corporate entities.”.

6 (d) *TRANSITION RULE FOR CERTAIN REGULATED IN-*
 7 *VESTMENT COMPANIES AND UNIT INVESTMENT TRUSTS.—*
 8 *Notwithstanding section 7874 of the Internal Revenue Code*
 9 *of 1986 (as added by subsection (a)), a regulated investment*
 10 *company, or other pooled fund or trust specified by the Sec-*
 11 *retary of the Treasury, may elect to recognize gain by rea-*
 12 *son of section 367(a) of such Code with respect to a trans-*
 13 *action under which a foreign incorporated entity is treated*
 14 *as an inverted domestic corporation under section 7874(a)*
 15 *of such Code by reason of an acquisition completed after*
 16 *March 20, 2002, and before January 1, 2004.*

17 **SEC. 442. IMPOSITION OF MARK-TO-MARKET TAX ON INDIV-**
 18 **VIDUALS WHO EXPATRIATE.**

19 (a) *IN GENERAL.—Subpart A of part II of subchapter*
 20 *N of chapter 1 is amended by inserting after section 877*
 21 *the following new section:*

22 **“SEC. 877A. TAX RESPONSIBILITIES OF EXPATRIATION.**

23 **“(a) GENERAL RULES.—For purposes of this sub-**
 24 **title—**

1 “(1) *MARK TO MARKET.*—Except as provided in
2 subsections (d) and (f), all property of a covered expa-
3 triate to whom this section applies shall be treated as
4 sold on the day before the expatriation date for its
5 fair market value.

6 “(2) *RECOGNITION OF GAIN OR LOSS.*—In the
7 case of any sale under paragraph (1)—

8 “(A) notwithstanding any other provision of
9 this title, any gain arising from such sale shall
10 be taken into account for the taxable year of the
11 sale, and

12 “(B) any loss arising from such sale shall
13 be taken into account for the taxable year of the
14 sale to the extent otherwise provided by this title,
15 except that section 1091 shall not apply to any
16 such loss.

17 *Proper adjustment shall be made in the amount of*
18 *any gain or loss subsequently realized for gain or loss*
19 *taken into account under the preceding sentence.*

20 “(3) *EXCLUSION FOR CERTAIN GAIN.*—

21 “(A) *IN GENERAL.*—The amount which, but
22 for this paragraph, would be includible in the
23 gross income of any individual by reason of this
24 section shall be reduced (but not below zero) by
25 \$600,000. For purposes of this paragraph, allo-

1 cable expatriation gain taken into account under
 2 subsection (f)(2) shall be treated in the same
 3 manner as an amount required to be includible
 4 in gross income.

5 “(B) COST-OF-LIVING ADJUSTMENT.—

6 “(i) IN GENERAL.—In the case of an
 7 expatriation date occurring in any calendar
 8 year after 2003, the \$600,000 amount under
 9 subparagraph (A) shall be increased by an
 10 amount equal to—

11 “(I) such dollar amount, multi-
 12 plied by

13 “(II) the cost-of-living adjustment
 14 determined under section 1(f)(3) for
 15 such calendar year, determined by sub-
 16 stituting ‘calendar year 2002’ for ‘cal-
 17 endar year 1992’ in subparagraph (B)
 18 thereof.

19 “(ii) ROUNDING RULES.—If any
 20 amount after adjustment under clause (i) is
 21 not a multiple of \$1,000, such amount shall
 22 be rounded to the next lower multiple of
 23 \$1,000.

24 “(4) ELECTION TO CONTINUE TO BE TAXED AS
 25 UNITED STATES CITIZEN.—

1 “(A) *IN GENERAL.*—If a covered expatriate
2 elects the application of this paragraph—

3 “(i) this section (other than this para-
4 graph and subsection (i)) shall not apply to
5 the expatriate, but

6 “(ii) in the case of property to which
7 this section would apply but for such elec-
8 tion, the expatriate shall be subject to tax
9 under this title in the same manner as if
10 the individual were a United States citizen.

11 “(B) *REQUIREMENTS.*—Subparagraph (A)
12 shall not apply to an individual unless the indi-
13 vidual—

14 “(i) provides security for payment of
15 tax in such form and manner, and in such
16 amount, as the Secretary may require,

17 “(ii) consents to the waiver of any
18 right of the individual under any treaty of
19 the United States which would preclude as-
20 sessment or collection of any tax which may
21 be imposed by reason of this paragraph,
22 and

23 “(iii) complies with such other require-
24 ments as the Secretary may prescribe.

1 “(C) *ELECTION*.—An election under sub-
 2 paragraph (A) shall apply to all property to
 3 which this section would apply but for the elec-
 4 tion and, once made, shall be irrevocable. Such
 5 election shall also apply to property the basis of
 6 which is determined in whole or in part by ref-
 7 erence to the property with respect to which the
 8 election was made.

9 “(b) *ELECTION TO DEFER TAX*.—

10 “(1) *IN GENERAL*.—If the taxpayer elects the ap-
 11 plication of this subsection with respect to any prop-
 12 erty treated as sold by reason of subsection (a), the
 13 payment of the additional tax attributable to such
 14 property shall be postponed until the due date of the
 15 return for the taxable year in which such property is
 16 disposed of (or, in the case of property disposed of in
 17 a transaction in which gain is not recognized in
 18 whole or in part, until such other date as the Sec-
 19 retary may prescribe).

20 “(2) *DETERMINATION OF TAX WITH RESPECT TO*
 21 *PROPERTY*.—For purposes of paragraph (1), the addi-
 22 tional tax attributable to any property is an amount
 23 which bears the same ratio to the additional tax im-
 24 posed by this chapter for the taxable year solely by
 25 reason of subsection (a) as the gain taken into ac-

1 count under subsection (a) with respect to such prop-
2 erty bears to the total gain taken into account under
3 subsection (a) with respect to all property to which
4 subsection (a) applies.

5 “(3) *TERMINATION OF POSTPONEMENT.*—No tax
6 may be postponed under this subsection later than the
7 due date for the return of tax imposed by this chapter
8 for the taxable year which includes the date of death
9 of the expatriate (or, if earlier, the time that the secu-
10 rity provided with respect to the property fails to
11 meet the requirements of paragraph (4), unless the
12 taxpayer corrects such failure within the time speci-
13 fied by the Secretary).

14 “(4) *SECURITY.*—

15 “(A) *IN GENERAL.*—No election may be
16 made under paragraph (1) with respect to any
17 property unless adequate security is provided to
18 the Secretary with respect to such property.

19 “(B) *ADEQUATE SECURITY.*—For purposes
20 of subparagraph (A), security with respect to
21 any property shall be treated as adequate secu-
22 rity if—

23 “(i) it is a bond in an amount equal
24 to the deferred tax amount under paragraph
25 (2) for the property, or

1 “(ii) the taxpayer otherwise establishes
2 to the satisfaction of the Secretary that the
3 security is adequate.

4 “(5) WAIVER OF CERTAIN RIGHTS.—No election
5 may be made under paragraph (1) unless the tax-
6 payer consents to the waiver of any right under any
7 treaty of the United States which would preclude as-
8 sessment or collection of any tax imposed by reason
9 of this section.

10 “(6) ELECTIONS.—An election under paragraph
11 (1) shall only apply to property described in the elec-
12 tion and, once made, is irrevocable. An election may
13 be made under paragraph (1) with respect to an in-
14 terest in a trust with respect to which gain is re-
15 quired to be recognized under subsection (f)(1).

16 “(7) INTEREST.—For purposes of section 6601—

17 “(A) the last date for the payment of tax
18 shall be determined without regard to the election
19 under this subsection, and

20 “(B) section 6621(a)(2) shall be applied by
21 substituting ‘5 percentage points’ for ‘3 percent-
22 age points’ in subparagraph (B) thereof.

23 “(c) COVERED EXPATRIATE.—For purposes of this sec-
24 tion—

1 “(1) *IN GENERAL.*—Except as provided in para-
2 graph (2), the term ‘covered expatriate’ means an ex-
3 patriate.

4 “(2) *EXCEPTIONS.*—An individual shall not be
5 treated as a covered expatriate if—

6 “(A) *the individual—*

7 “(i) *became at birth a citizen of the*
8 *United States and a citizen of another*
9 *country and, as of the expatriation date,*
10 *continues to be a citizen of, and is taxed as*
11 *a resident of, such other country, and*

12 “(ii) *has not been a resident of the*
13 *United States (as defined in section*
14 *7701(b)(1)(A)(ii)) during the 5 taxable*
15 *years ending with the taxable year during*
16 *which the expatriation date occurs, or*

17 “(B)(i) *the individual’s relinquishment of*
18 *United States citizenship occurs before such indi-*
19 *vidual attains age 18½, and*

20 “(ii) *the individual has been a resident of*
21 *the United States (as so defined) for not more*
22 *than 5 taxable years before the date of relin-*
23 *quishment.*

24 “(d) *EXEMPT PROPERTY; SPECIAL RULES FOR PEN-*
25 *SION PLANS.—*

1 “(1) *EXEMPT PROPERTY.*—*This section shall not*
2 *apply to the following:*

3 “(A) *UNITED STATES REAL PROPERTY IN-*
4 *TERESTS.*—*Any United States real property in-*
5 *terest (as defined in section 897(c)(1)), other*
6 *than stock of a United States real property hold-*
7 *ing corporation which does not, on the day before*
8 *the expatriation date, meet the requirements of*
9 *section 897(c)(2).*

10 “(B) *SPECIFIED PROPERTY.*—*Any property*
11 *or interest in property not described in subpara-*
12 *graph (A) which the Secretary specifies in regu-*
13 *lations.*

14 “(2) *SPECIAL RULES FOR CERTAIN RETIREMENT*
15 *PLANS.*—

16 “(A) *IN GENERAL.*—*If a covered expatriate*
17 *holds on the day before the expatriation date any*
18 *interest in a retirement plan to which this para-*
19 *graph applies—*

20 “(i) *such interest shall not be treated*
21 *as sold for purposes of subsection (a)(1), but*

22 “(ii) *an amount equal to the present*
23 *value of the expatriate’s nonforfeitable ac-*
24 *crued benefit shall be treated as having been*

1 *received by such individual on such date as*
2 *a distribution under the plan.*

3 “(B) *TREATMENT OF SUBSEQUENT DIS-*
4 *TRIBUTIONS.—In the case of any distribution on*
5 *or after the expatriation date to or on behalf of*
6 *the covered expatriate from a plan from which*
7 *the expatriate was treated as receiving a dis-*
8 *tribution under subparagraph (A), the amount*
9 *otherwise includible in gross income by reason of*
10 *the subsequent distribution shall be reduced by*
11 *the excess of the amount includible in gross in-*
12 *come under subparagraph (A) over any portion*
13 *of such amount to which this subparagraph pre-*
14 *viously applied.*

15 “(C) *TREATMENT OF SUBSEQUENT DIS-*
16 *TRIBUTIONS BY PLAN.—For purposes of this title,*
17 *a retirement plan to which this paragraph ap-*
18 *plies, and any person acting on the plan’s behalf,*
19 *shall treat any subsequent distribution described*
20 *in subparagraph (B) in the same manner as*
21 *such distribution would be treated without re-*
22 *gard to this paragraph.*

23 “(D) *APPLICABLE PLANS.—This paragraph*
24 *shall apply to—*

1 “(i) any qualified retirement plan (as
2 defined in section 4974(c)),

3 “(ii) an eligible deferred compensation
4 plan (as defined in section 457(b)) of an el-
5 igible employer described in section
6 457(e)(1)(A), and

7 “(iii) to the extent provided in regula-
8 tions, any foreign pension plan or similar
9 retirement arrangements or programs.

10 “(e) *DEFINITIONS.*—For purposes of this section—

11 “(1) *EXPATRIATE.*—The term ‘expatriate’
12 means—

13 “(A) any United States citizen who relin-
14 quishes citizenship, and

15 “(B) any long-term resident of the United
16 States who—

17 “(i) ceases to be a lawful permanent
18 resident of the United States (within the
19 meaning of section 7701(b)(6)), or

20 “(ii) commences to be treated as a resi-
21 dent of a foreign country under the provi-
22 sions of a tax treaty between the United
23 States and the foreign country and who
24 does not waive the benefits of such treaty

1 applicable to residents of the foreign coun-
2 try.

3 “(2) *EXPATRIATION DATE.*—The term ‘expatria-
4 tion date’ means—

5 “(A) the date an individual relinquishes
6 United States citizenship, or

7 “(B) in the case of a long-term resident of
8 the United States, the date of the event described
9 in clause (i) or (ii) of paragraph (1)(B).

10 “(3) *RELINQUISHMENT OF CITIZENSHIP.*—A cit-
11 izen shall be treated as relinquishing United States
12 citizenship on the earliest of—

13 “(A) the date the individual renounces such
14 individual’s United States nationality before a
15 diplomatic or consular officer of the United
16 States pursuant to paragraph (5) of section
17 349(a) of the Immigration and Nationality Act
18 (8 U.S.C. 1481(a)(5)),

19 “(B) the date the individual furnishes to the
20 United States Department of State a signed
21 statement of voluntary relinquishment of United
22 States nationality confirming the performance of
23 an act of expatriation specified in paragraph
24 (1), (2), (3), or (4) of section 349(a) of the Im-

1 *migration and Nationality Act (8 U.S.C.*
 2 *1481(a)(1)–(4)),*

3 “(C) *the date the United States Department*
 4 *of State issues to the individual a certificate of*
 5 *loss of nationality, or*

6 “(D) *the date a court of the United States*
 7 *cancels a naturalized citizen’s certificate of natu-*
 8 *ralization.*

9 *Subparagraph (A) or (B) shall not apply to any in-*
 10 *dividual unless the renunciation or voluntary relin-*
 11 *quishment is subsequently approved by the issuance to*
 12 *the individual of a certificate of loss of nationality by*
 13 *the United States Department of State.*

14 “(4) *LONG-TERM RESIDENT.—The term ‘long-*
 15 *term resident’ has the meaning given to such term by*
 16 *section 877(e)(2).*

17 “(f) *SPECIAL RULES APPLICABLE TO BENEFICIARIES’*
 18 *INTERESTS IN TRUST.—*

19 “(1) *IN GENERAL.—Except as provided in para-*
 20 *graph (2), if an individual is determined under para-*
 21 *graph (3) to hold an interest in a trust on the day*
 22 *before the expatriation date—*

23 “(A) *the individual shall not be treated as*
 24 *having sold such interest,*

1 “(B) such interest shall be treated as a sep-
2 arate share in the trust, and

3 “(C)(i) such separate share shall be treated
4 as a separate trust consisting of the assets allo-
5 cable to such share,

6 “(ii) the separate trust shall be treated as
7 having sold its assets on the day before the expa-
8 triation date for their fair market value and as
9 having distributed all of its assets to the indi-
10 vidual as of such time, and

11 “(iii) the individual shall be treated as hav-
12 ing recontributed the assets to the separate trust.

13 Subsection (a)(2) shall apply to any income, gain, or
14 loss of the individual arising from a distribution de-
15 scribed in subparagraph (C)(ii). In determining the
16 amount of such distribution, proper adjustments shall
17 be made for liabilities of the trust allocable to an in-
18 dividual's share in the trust.

19 “(2) SPECIAL RULES FOR INTERESTS IN QUALI-
20 FIED TRUSTS.—

21 “(A) IN GENERAL.—If the trust interest de-
22 scribed in paragraph (1) is an interest in a
23 qualified trust—

24 “(i) paragraph (1) and subsection (a)
25 shall not apply, and

1 “(ii) in addition to any other tax im-
 2 posed by this title, there is hereby imposed
 3 on each distribution with respect to such in-
 4 terest a tax in the amount determined
 5 under subparagraph (B).

6 “(B) AMOUNT OF TAX.—The amount of tax
 7 under subparagraph (A)(ii) shall be equal to the
 8 lesser of—

9 “(i) the highest rate of tax imposed by
 10 section 1(e) for the taxable year which in-
 11 cludes the day before the expatriation date,
 12 multiplied by the amount of the distribu-
 13 tion, or

14 “(ii) the balance in the deferred tax ac-
 15 count immediately before the distribution
 16 determined without regard to any increases
 17 under subparagraph (C)(ii) after the 30th
 18 day preceding the distribution.

19 “(C) DEFERRED TAX ACCOUNT.—For pur-
 20 poses of subparagraph (B)(ii)—

21 “(i) OPENING BALANCE.—The opening
 22 balance in a deferred tax account with re-
 23 spect to any trust interest is an amount
 24 equal to the tax which would have been im-
 25 posed on the allocable expatriation gain

1 with respect to the trust interest if such
2 gain had been included in gross income
3 under subsection (a).

4 “(ii) INCREASE FOR INTEREST.—The
5 balance in the deferred tax account shall be
6 increased by the amount of interest deter-
7 mined (on the balance in the account at the
8 time the interest accrues), for periods after
9 the 90th day after the expatriation date, by
10 using the rates and method applicable
11 under section 6621 for underpayments of
12 tax for such periods, except that section
13 6621(a)(2) shall be applied by substituting
14 ‘5 percentage points’ for ‘3 percentage
15 points’ in subparagraph (B) thereof.

16 “(iii) DECREASE FOR TAXES PRE-
17 VIOUSLY PAID.—The balance in the tax de-
18 ferred account shall be reduced—

19 “(I) by the amount of taxes im-
20 posed by subparagraph (A) on any dis-
21 tribution to the person holding the
22 trust interest, and

23 “(II) in the case of a person hold-
24 ing a nonvested interest, to the extent
25 provided in regulations, by the amount

1 of taxes imposed by subparagraph (A)
 2 on distributions from the trust with re-
 3 spect to nonvested interests not held by
 4 such person.

5 “(D) *ALLOCABLE EXPATRIATION GAIN.*—For
 6 purposes of this paragraph, the allocable expa-
 7 triation gain with respect to any beneficiary’s
 8 interest in a trust is the amount of gain which
 9 would be allocable to such beneficiary’s vested
 10 and nonvested interests in the trust if the bene-
 11 ficiary held directly all assets allocable to such
 12 interests.

13 “(E) *TAX DEDUCTED AND WITHHELD.*—

14 “(i) *IN GENERAL.*—The tax imposed by
 15 subparagraph (A)(ii) shall be deducted and
 16 withheld by the trustees from the distribu-
 17 tion to which it relates.

18 “(ii) *EXCEPTION WHERE FAILURE TO*
 19 *WAIVE TREATY RIGHTS.*—If an amount may
 20 not be deducted and withheld under clause
 21 (i) by reason of the distributee failing to
 22 waive any treaty right with respect to such
 23 distribution—

24 “(I) the tax imposed by subpara-
 25 graph (A)(ii) shall be imposed on the

1 trust and each trustee shall be person-
2 ally liable for the amount of such tax,
3 and

4 “(II) any other beneficiary of the
5 trust shall be entitled to recover from
6 the distributee the amount of such tax
7 imposed on the other beneficiary.

8 “(F) DISPOSITION.—If a trust ceases to be
9 a qualified trust at any time, a covered expa-
10 triate disposes of an interest in a qualified trust,
11 or a covered expatriate holding an interest in a
12 qualified trust dies, then, in lieu of the tax im-
13 posed by subparagraph (A)(ii), there is hereby
14 imposed a tax equal to the lesser of—

15 “(i) the tax determined under para-
16 graph (1) as if the day before the expatria-
17 tion date were the date of such cessation,
18 disposition, or death, whichever is applica-
19 ble, or

20 “(ii) the balance in the tax deferred ac-
21 count immediately before such date.

22 Such tax shall be imposed on the trust and each
23 trustee shall be personally liable for the amount
24 of such tax and any other beneficiary of the trust
25 shall be entitled to recover from the covered expa-

1 *triate or the estate the amount of such tax im-*
 2 *posed on the other beneficiary.*

3 *“(G) DEFINITIONS AND SPECIAL RULES.—*

4 *For purposes of this paragraph—*

5 *“(i) QUALIFIED TRUST.—The term*
 6 *‘qualified trust’ means a trust which is de-*
 7 *scribed in section 7701(a)(30)(E).*

8 *“(ii) VESTED INTEREST.—The term*
 9 *‘vested interest’ means any interest which,*
 10 *as of the day before the expatriation date, is*
 11 *vested in the beneficiary.*

12 *“(iii) NONVESTED INTEREST.—The*
 13 *term ‘nonvested interest’ means, with re-*
 14 *spect to any beneficiary, any interest in a*
 15 *trust which is not a vested interest. Such*
 16 *interest shall be determined by assuming the*
 17 *maximum exercise of discretion in favor of*
 18 *the beneficiary and the occurrence of all*
 19 *contingencies in favor of the beneficiary.*

20 *“(iv) ADJUSTMENTS.—The Secretary*
 21 *may provide for such adjustments to the*
 22 *bases of assets in a trust or a deferred tax*
 23 *account, and the timing of such adjust-*
 24 *ments, in order to ensure that gain is taxed*
 25 *only once.*

1 “(v) *COORDINATION WITH RETIREMENT*
 2 *PLAN RULES.—This subsection shall not*
 3 *apply to an interest in a trust which is*
 4 *part of a retirement plan to which sub-*
 5 *section (d)(2) applies.*

6 “(3) *DETERMINATION OF BENEFICIARIES’ INTER-*
 7 *EST IN TRUST.—*

8 “(A) *DETERMINATIONS UNDER PARAGRAPH*
 9 *(1).—For purposes of paragraph (1), a bene-*
 10 *ficiary’s interest in a trust shall be based upon*
 11 *all relevant facts and circumstances, including*
 12 *the terms of the trust instrument and any letter*
 13 *of wishes or similar document, historical pat-*
 14 *terns of trust distributions, and the existence of*
 15 *and functions performed by a trust protector or*
 16 *any similar adviser.*

17 “(B) *OTHER DETERMINATIONS.—For pur-*
 18 *poses of this section—*

19 “(i) *CONSTRUCTIVE OWNERSHIP.—If a*
 20 *beneficiary of a trust is a corporation, part-*
 21 *nership, trust, or estate, the shareholders,*
 22 *partners, or beneficiaries shall be deemed to*
 23 *be the trust beneficiaries for purposes of this*
 24 *section.*

1 “(ii) *TAXPAYER RETURN POSITION.*—A
2 *taxpayer shall clearly indicate on its in-*
3 *come tax return—*

4 “(I) *the methodology used to de-*
5 *termine that taxpayer’s trust interest*
6 *under this section, and*

7 “(II) *if the taxpayer knows (or*
8 *has reason to know) that any other*
9 *beneficiary of such trust is using a dif-*
10 *ferent methodology to determine such*
11 *beneficiary’s trust interest under this*
12 *section.*

13 “(g) *TERMINATION OF DEFERRALS, ETC.*—*In the case*
14 *of any covered expatriate, notwithstanding any other provi-*
15 *sion of this title—*

16 “(1) *any period during which recognition of in-*
17 *come or gain is deferred shall terminate on the day*
18 *before the expatriation date, and*

19 “(2) *any extension of time for payment of tax*
20 *shall cease to apply on the day before the expatriation*
21 *date and the unpaid portion of such tax shall be due*
22 *and payable at the time and in the manner pre-*
23 *scribed by the Secretary.*

24 “(h) *IMPOSITION OF TENTATIVE TAX.*—

1 “(1) *IN GENERAL.*—If an individual is required
 2 to include any amount in gross income under sub-
 3 section (a) for any taxable year, there is hereby im-
 4 posed, immediately before the expatriation date, a tax
 5 in an amount equal to the amount of tax which
 6 would be imposed if the taxable year were a short tax-
 7 able year ending on the expatriation date.

8 “(2) *DUE DATE.*—The due date for any tax im-
 9 posed by paragraph (1) shall be the 90th day after the
 10 expatriation date.

11 “(3) *TREATMENT OF TAX.*—Any tax paid under
 12 paragraph (1) shall be treated as a payment of the
 13 tax imposed by this chapter for the taxable year to
 14 which subsection (a) applies.

15 “(4) *DEFERRAL OF TAX.*—The provisions of sub-
 16 section (b) shall apply to the tax imposed by this sub-
 17 section to the extent attributable to gain includible in
 18 gross income by reason of this section.

19 “(i) *SPECIAL LIENS FOR DEFERRED TAX AMOUNTS.*—

20 “(1) *IMPOSITION OF LIEN.*—

21 “(A) *IN GENERAL.*—If a covered expatriate
 22 makes an election under subsection (a)(4) or (b)
 23 which results in the deferral of any tax imposed
 24 by reason of subsection (a), the deferred amount
 25 (including any interest, additional amount, ad-

1 *dition to tax, assessable penalty, and costs at-*
 2 *tributable to the deferred amount) shall be a lien*
 3 *in favor of the United States on all property of*
 4 *the expatriate located in the United States (with-*
 5 *out regard to whether this section applies to the*
 6 *property).*

7 *“(B) DEFERRED AMOUNT.—For purposes of*
 8 *this subsection, the deferred amount is the*
 9 *amount of the increase in the covered expatri-*
 10 *ate’s income tax which, but for the election under*
 11 *subsection (a)(4) or (b), would have occurred by*
 12 *reason of this section for the taxable year includ-*
 13 *ing the expatriation date.*

14 *“(2) PERIOD OF LIEN.—The lien imposed by this*
 15 *subsection shall arise on the expatriation date and*
 16 *continue until—*

17 *“(A) the liability for tax by reason of this*
 18 *section is satisfied or has become unenforceable*
 19 *by reason of lapse of time, or*

20 *“(B) it is established to the satisfaction of*
 21 *the Secretary that no further tax liability may*
 22 *arise by reason of this section.*

23 *“(3) CERTAIN RULES APPLY.—The rules set forth*
 24 *in paragraphs (1), (3), and (4) of section 6324A(d)*
 25 *shall apply with respect to the lien imposed by this*

1 subsection as if it were a lien imposed by section
2 6324A.

3 “(j) *REGULATIONS.*—The Secretary shall prescribe
4 such regulations as may be necessary or appropriate to
5 carry out the purposes of this section.”.

6 (b) *INCLUSION IN INCOME OF GIFTS AND BEQUESTS*
7 *RECEIVED BY UNITED STATES CITIZENS AND RESIDENTS*
8 *FROM EXPATRIATES.*—Section 102 (relating to gifts, etc.
9 not included in gross income) is amended by adding at the
10 end the following new subsection:

11 “(d) *GIFTS AND INHERITANCES FROM COVERED EX-*
12 *PATRIATES.*—

13 “(1) *IN GENERAL.*—Subsection (a) shall not ex-
14 clude from gross income the value of any property ac-
15 quired by gift, bequest, devise, or inheritance from a
16 covered expatriate after the expatriation date. For
17 purposes of this subsection, any term used in this sub-
18 section which is also used in section 877A shall have
19 the same meaning as when used in section 877A.

20 “(2) *EXCEPTIONS FOR TRANSFERS OTHERWISE*
21 *SUBJECT TO ESTATE OR GIFT TAX.*—Paragraph (1)
22 shall not apply to any property if either—

23 “(A) the gift, bequest, devise, or inheritance
24 is—

1 “(i) shown on a timely filed return of
2 tax imposed by chapter 12 as a taxable gift
3 by the covered expatriate, or

4 “(ii) included in the gross estate of the
5 covered expatriate for purposes of chapter
6 11 and shown on a timely filed return of
7 tax imposed by chapter 11 of the estate of
8 the covered expatriate, or

9 “(B) no such return was timely filed but no
10 such return would have been required to be filed
11 even if the covered expatriate were a citizen or
12 long-term resident of the United States.”.

13 (c) *DEFINITION OF TERMINATION OF UNITED STATES*
14 *CITIZENSHIP.*—Section 7701(a) is amended by adding at
15 the end the following new paragraph:

16 “(48) *TERMINATION OF UNITED STATES CITIZEN-*
17 *SHIP.*—

18 “(A) *IN GENERAL.*—An individual shall not
19 cease to be treated as a United States citizen be-
20 fore the date on which the individual’s citizen-
21 ship is treated as relinquished under section
22 877A(e)(3).

23 “(B) *DUAL CITIZENS.*—Under regulations
24 prescribed by the Secretary, subparagraph (A)
25 shall not apply to an individual who became at

1 *birth a citizen of the United States and a citizen*
 2 *of another country.”.*

3 (d) *INELIGIBILITY FOR VISA OR ADMISSION TO*
 4 *UNITED STATES.—*

5 (1) *IN GENERAL.—Section 212(a)(10)(E) of the*
 6 *Immigration and Nationality Act (8 U.S.C.*
 7 *1182(a)(10)(E)) is amended to read as follows:*

8 “(E) *FORMER CITIZENS NOT IN COMPLI-*
 9 *ANCE WITH EXPATRIATION REVENUE PROVI-*
 10 *SIONS.—Any alien who is a former citizen of the*
 11 *United States who relinquishes United States*
 12 *citizenship (within the meaning of section*
 13 *877A(e)(3) of the Internal Revenue Code of 1986)*
 14 *and who is not in compliance with section 877A*
 15 *of such Code (relating to expatriation).”.*

16 (2) *AVAILABILITY OF INFORMATION.—*

17 (A) *IN GENERAL.—Section 6103(l) (relating*
 18 *to disclosure of returns and return information*
 19 *for purposes other than tax administration) is*
 20 *amended by adding at the end the following new*
 21 *paragraph:*

22 “(19) *DISCLOSURE TO DENY VISA OR ADMISSION*
 23 *TO CERTAIN EXPATRIATES.—Upon written request of*
 24 *the Attorney General or the Attorney General’s dele-*
 25 *gate, the Secretary shall disclose whether an indi-*

vidual is in compliance with section 877A (and if not in compliance, any items of noncompliance) to officers and employees of the Federal agency responsible for administering section 212(a)(10)(E) of the Immigration and Nationality Act solely for the purpose of, and to the extent necessary in, administering such section 212(a)(10)(E).”.

(B) SAFEGUARDS.—

(i) TECHNICAL AMENDMENTS.—Paragraph (4) of section 6103(p) of the Internal Revenue Code of 1986, as amended by section 202(b)(2)(B) of the Trade Act of 2002 (Public Law 107-210; 116 Stat. 961), is amended by striking “or (17)” after “any other person described in subsection (l)(16)” each place it appears and inserting “or (18)”.

(ii) CONFORMING AMENDMENTS.—Section 6103(p)(4) (relating to safeguards), as amended by clause (i), is amended by striking “or (18)” after “any other person described in subsection (l)(16)” each place it appears and inserting “(18), or (19)”.

(3) EFFECTIVE DATES.—

1 (A) *IN GENERAL.*—*Except as provided in*
 2 *subparagraph (B), the amendments made by this*
 3 *subsection shall apply to individuals who relin-*
 4 *quish United States citizenship on or after the*
 5 *date of the enactment of this Act.*

6 (B) *TECHNICAL AMENDMENTS.*—*The*
 7 *amendments made by paragraph (2)(B)(i) shall*
 8 *take effect as if included in the amendments*
 9 *made by section 202(b)(2)(B) of the Trade Act of*
 10 *2002 (Public Law 107-210; 116 Stat. 961).*

11 (e) *CONFORMING AMENDMENTS.*—

12 (1) *Section 877 is amended by adding at the end*
 13 *the following new subsection:*

14 “(g) *APPLICATION.*—*This section shall not apply to an*
 15 *expatriate (as defined in section 877A(e)) whose expatria-*
 16 *tion date (as so defined) occurs on or after February 5,*
 17 *2003.”.*

18 (2) *Section 2107 is amended by adding at the*
 19 *end the following new subsection:*

20 “(f) *APPLICATION.*—*This section shall not apply to*
 21 *any expatriate subject to section 877A.”.*

22 (3) *Section 2501(a)(3) is amended by adding at*
 23 *the end the following new subparagraph:*

1 “(F) *APPLICATION.*—*This paragraph shall*
 2 *not apply to any expatriate subject to section*
 3 *877A.”.*

4 (4)(A) *Paragraph (1) of section 6039G(d) is*
 5 *amended by inserting “or 877A” after “section 877”.*

6 (B) *The second sentence of section 6039G(e) is*
 7 *amended by inserting “or who relinquishes United*
 8 *States citizenship (within the meaning of section*
 9 *877A(e)(3))” after “877(a)”.*

10 (C) *Section 6039G(f) is amended by inserting*
 11 *“or 877A(e)(2)(B)” after “877(e)(1)”.*

12 (f) *CLERICAL AMENDMENT.*—*The table of sections for*
 13 *subpart A of part II of subchapter N of chapter 1 is amend-*
 14 *ed by inserting after the item relating to section 877 the*
 15 *following new item:*

“Sec. 877A. Tax responsibilities of expatriation.”.

16 (g) *EFFECTIVE DATE.*—

17 (1) *IN GENERAL.*—*Except as provided in this*
 18 *subsection, the amendments made by this section shall*
 19 *apply to expatriates (within the meaning of section*
 20 *877A(e) of the Internal Revenue Code of 1986, as*
 21 *added by this section) whose expatriation date (as so*
 22 *defined) occurs on or after February 5, 2003.*

23 (2) *GIFTS AND BEQUESTS.*—*Section 102(d) of*
 24 *the Internal Revenue Code of 1986 (as added by sub-*
 25 *section (b)) shall apply to gifts and bequests received*

1 on or after February 5, 2003, from an individual or
 2 the estate of an individual whose expatriation date
 3 (as so defined) occurs after such date.

4 (3) *DUE DATE FOR TENTATIVE TAX.*—The due
 5 date under section 877A(h)(2) of the Internal Revenue
 6 Code of 1986, as added by this section, shall in no
 7 event occur before the 90th day after the date of the
 8 enactment of this Act.

9 **SEC. 443. EXCISE TAX ON STOCK COMPENSATION OF INSID-**
 10 **ERS IN INVERTED CORPORATIONS.**

11 (a) *IN GENERAL.*—Subtitle D is amended by adding
 12 at the end the following new chapter:

13 **“CHAPTER 48—STOCK COMPENSATION OF**
 14 **INSIDERS IN INVERTED CORPORATIONS**

 “Sec. 5000A. Stock compensation of insiders in inverted corpora-
 tions entities.

15 **“SEC. 5000A. STOCK COMPENSATION OF INSIDERS IN IN-**
 16 **VERTED CORPORATIONS.**

17 “(a) *IMPOSITION OF TAX.*—In the case of an indi-
 18 vidual who is a disqualified individual with respect to any
 19 inverted corporation, there is hereby imposed on such per-
 20 son a tax equal to 20 percent of the value (determined under
 21 subsection (b)) of the specified stock compensation held (di-
 22 rectly or indirectly) by or for the benefit of such individual
 23 or a member of such individual’s family (as defined in sec-
 24 tion 267) at any time during the 12-month period begin-

1 *ning on the date which is 6 months before the inversion*
 2 *date.*

3 *“(b) VALUE.—For purposes of subsection (a)—*

4 *“(1) IN GENERAL.—The value of specified stock*
 5 *compensation shall be—*

6 *“(A) in the case of a stock option (or other*
 7 *similar right) or any stock appreciation right,*
 8 *the fair value of such option or right, and*

9 *“(B) in any other case, the fair market*
 10 *value of such compensation.*

11 *“(2) DATE FOR DETERMINING VALUE.—The de-*
 12 *termination of value shall be made—*

13 *“(A) in the case of specified stock compensa-*
 14 *tion held on the inversion date, on such date,*

15 *“(B) in the case of such compensation which*
 16 *is canceled during the 6 months before the inver-*
 17 *sion date, on the day before such cancellation,*
 18 *and*

19 *“(C) in the case of such compensation which*
 20 *is granted after the inversion date, on the date*
 21 *such compensation is granted.*

22 *“(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN*
 23 *RECOGNIZED.—Subsection (a) shall apply to any disquali-*
 24 *fied individual with respect to an inverted corporation only*
 25 *if gain (if any) on any stock in such corporation is recog-*

1 nized in whole or part by any shareholder by reason of the
 2 acquisition referred to in section 7874(a)(2)(A) (determined
 3 by substituting 'July 10, 2002' for 'March 20, 2002') with
 4 respect to such corporation.

5 “(d) *EXCEPTION WHERE GAIN RECOGNIZED ON COM-*
 6 *PENSATION.*—Subsection (a) shall not apply to—

7 “(1) any stock option which is exercised on the
 8 inversion date or during the 6-month period before
 9 such date and to the stock acquired in such exercise,
 10 if income is recognized under section 83 on or before
 11 the inversion date with respect to the stock acquired
 12 pursuant to such exercise, and

13 “(2) any specified stock compensation which is
 14 exercised, sold, exchanged, distributed, cashed out, or
 15 otherwise paid during such period in a transaction in
 16 which gain or loss is recognized in full.

17 “(e) *DEFINITIONS.*—For purposes of this section—

18 “(1) *DISQUALIFIED INDIVIDUAL.*—The term ‘dis-
 19 qualified individual’ means, with respect to a cor-
 20 poration, any individual who, at any time during the
 21 12-month period beginning on the date which is 6
 22 months before the inversion date—

23 “(A) is subject to the requirements of section
 24 16(a) of the Securities Exchange Act of 1934
 25 with respect to such corporation, or

1 “(B) would be subject to such requirements
2 if such corporation were an issuer of equity secu-
3 rities referred to in such section.

4 “(2) *INVERTED CORPORATION; INVERSION*
5 *DATE.*—

6 “(A) *INVERTED CORPORATION.*—The term
7 ‘inverted corporation’ means any corporation to
8 which subsection (a) or (b) of section 7874 ap-
9 plies determined—

10 “(i) by substituting ‘July 10, 2002’ for
11 ‘March 20, 2002’ in section 7874(a)(2)(A),
12 and

13 “(ii) without regard to subsection
14 (b)(1)(A).

15 Such term includes any predecessor or successor
16 of such a corporation.

17 “(B) *INVERSION DATE.*—The term ‘inver-
18 sion date’ means, with respect to a corporation,
19 the date on which the corporation first becomes
20 an inverted corporation.

21 “(3) *SPECIFIED STOCK COMPENSATION.*—

22 “(A) *IN GENERAL.*—The term ‘specified
23 stock compensation’ means payment (or right to
24 payment) granted by the inverted corporation
25 (or by any member of the expanded affiliated

1 group which includes such corporation) to any
 2 person in connection with the performance of
 3 services by a disqualified individual for such cor-
 4 poration or member if the value of such payment
 5 or right is based on (or determined by reference
 6 to) the value (or change in value) of stock in
 7 such corporation (or any such member).

8 “(B) *EXCEPTIONS.*—Such term shall not in-
 9 clude—

10 “(i) any option to which part II of
 11 subchapter D of chapter 1 applies, or

12 “(ii) any payment or right to payment
 13 from a plan referred to in section
 14 280G(b)(6).

15 “(4) *EXPANDED AFFILIATED GROUP.*—The term
 16 ‘expanded affiliated group’ means an affiliated group
 17 (as defined in section 1504(a) without regard to sec-
 18 tion 1504(b)(3)); except that section 1504(a) shall be
 19 applied by substituting ‘more than 50 percent’ for ‘at
 20 least 80 percent’ each place it appears.

21 “(f) *SPECIAL RULES.*—For purposes of this section—

22 “(1) *CANCELLATION OF RESTRICTION.*—The can-
 23 cellation of a restriction which by its terms will never
 24 lapse shall be treated as a grant.

1 “(2) *PAYMENT OR REIMBURSEMENT OF TAX BY*
 2 *CORPORATION TREATED AS SPECIFIED STOCK COM-*
 3 *PENSATION.—Any payment of the tax imposed by this*
 4 *section directly or indirectly by the inverted corpora-*
 5 *tion or by any member of the expanded affiliated*
 6 *group which includes such corporation—*

7 “(A) *shall be treated as specified stock com-*
 8 *pensation, and*

9 “(B) *shall not be allowed as a deduction*
 10 *under any provision of chapter 1.*

11 “(3) *CERTAIN RESTRICTIONS IGNORED.—Wheth-*
 12 *er there is specified stock compensation, and the value*
 13 *thereof, shall be determined without regard to any re-*
 14 *striction other than a restriction which by its terms*
 15 *will never lapse.*

16 “(4) *PROPERTY TRANSFERS.—Any transfer of*
 17 *property shall be treated as a payment and any right*
 18 *to a transfer of property shall be treated as a right*
 19 *to a payment.*

20 “(5) *OTHER ADMINISTRATIVE PROVISIONS.—For*
 21 *purposes of subtitle F, any tax imposed by this sec-*
 22 *tion shall be treated as a tax imposed by subtitle A.*

23 “(g) *REGULATIONS.—The Secretary shall prescribe*
 24 *such regulations as may be necessary or appropriate to*
 25 *carry out the purposes of this section.”.*

1 (b) *DENIAL OF DEDUCTION.*—

2 (1) *IN GENERAL.*—Paragraph (6) of section
3 275(a) is amended by inserting “48,” after “46,”.

4 (2) *\$1,000,000 LIMIT ON DEDUCTIBLE COM-*
5 *PENSATION REDUCED BY PAYMENT OF EXCISE TAX ON*
6 *SPECIFIED STOCK COMPENSATION.*—Paragraph (4) of
7 section 162(m) is amended by adding at the end the
8 following new subparagraph:

9 “(G) *COORDINATION WITH EXCISE TAX ON*
10 *SPECIFIED STOCK COMPENSATION.*—The dollar
11 limitation contained in paragraph (1) with re-
12 spect to any covered employee shall be reduced
13 (but not below zero) by the amount of any pay-
14 ment (with respect to such employee) of the tax
15 imposed by section 5000A directly or indirectly
16 by the inverted corporation (as defined in such
17 section) or by any member of the expanded affili-
18 ated group (as defined in such section) which in-
19 cludes such corporation.”.

20 (c) *CONFORMING AMENDMENTS.*—

21 (1) The last sentence of section 3121(v)(2)(A) is
22 amended by inserting before the period “or to any
23 specified stock compensation (as defined in section
24 5000A) on which tax is imposed by section 5000A”.

1 (2) *The table of chapters for subtitle D is amend-*
 2 *ed by adding at the end the following new item:*

“Chapter 48. Stock compensation of insiders in inverted corporations.”.

3 (d) *EFFECTIVE DATE.*—*The amendments made by this*
 4 *section shall take effect on July 11, 2002; except that periods*
 5 *before such date shall not be taken into account in applying*
 6 *the periods in subsections (a) and (e)(1) of section 5000A*
 7 *of the Internal Revenue Code of 1986, as added by this sec-*
 8 *tion.*

9 **SEC. 444. REINSURANCE OF UNITED STATES RISKS IN FOR-**
 10 **EIGN JURISDICTIONS.**

11 (a) *IN GENERAL.*—*Section 845(a) (relating to alloca-*
 12 *tion in case of reinsurance agreement involving tax avoid-*
 13 *ance or evasion) is amended by striking “source and char-*
 14 *acter” and inserting “amount, source, or character”.*

15 (b) *EFFECTIVE DATE.*—*The amendments made by this*
 16 *section shall apply to any risk reinsured after April 11,*
 17 *2002.*

18 **SEC. 445. REPORTING OF TAXABLE MERGERS AND ACQUISI-**
 19 **TIONS.**

20 (a) *IN GENERAL.*—*Subpart B of part III of subchapter*
 21 *A of chapter 61 is amended by inserting after section 6043*
 22 *the following new section:*

1 **"SEC. 6043A. TAXABLE MERGERS AND ACQUISITIONS.**

2 “(a) *IN GENERAL.*—*The acquiring corporation in any*
3 *taxable acquisition shall make a return (according to the*
4 *forms or regulations prescribed by the Secretary) setting*
5 *forth—*

6 “(1) *a description of the acquisition,*

7 “(2) *the name and address of each shareholder of*
8 *the acquired corporation who is required to recognize*
9 *gain (if any) as a result of the acquisition,*

10 “(3) *the amount of money and the fair market*
11 *value of other property transferred to each such share-*
12 *holder as part of such acquisition, and*

13 “(4) *such other information as the Secretary*
14 *may prescribe.*

15 *To the extent provided by the Secretary, the requirements*
16 *of this section applicable to the acquiring corporation shall*
17 *be applicable to the acquired corporation and not to the*
18 *acquiring corporation.*

19 “(b) *NOMINEE REPORTING.*—*Any person who holds*
20 *stock as a nominee for another person shall furnish in the*
21 *manner prescribed by the Secretary to such other person*
22 *the information provided by the corporation under sub-*
23 *section (d).*

24 “(c) *TAXABLE ACQUISITION.*—*For purposes of this sec-*
25 *tion, the term ‘taxable acquisition’ means any acquisition*
26 *by a corporation of stock in or property of another corpora-*

tion if any shareholder of the acquired corporation is required to recognize gain (if any) as a result of such acquisition.

“(d) STATEMENTS TO BE FURNISHED TO SHAREHOLDERS.—Every person required to make a return under subsection (a) shall furnish to each shareholder whose name is required to be set forth in such return a written statement showing—

“(1) the name, address, and phone number of the information contact of the person required to make such return,

“(2) the information required to be shown on such return with respect to such shareholder, and

“(3) such other information as the Secretary may prescribe.

The written statement required under the preceding sentence shall be furnished to the shareholder on or before January 31 of the year following the calendar year during which the taxable acquisition occurred.”.

(b) ASSESSABLE PENALTIES.—

(1) Subparagraph (B) of section 6724(d)(1) (relating to definitions) is amended by redesignating clauses (ii) through (xvii) as clauses (iii) through (xviii), respectively, and by inserting after clause (i) the following new clause:

1 “(ii) section 6043A(a) (relating to re-
2 turns relating to taxable mergers and acqui-
3 sitions),”.

4 (2) Paragraph (2) of section 6724(d) is amended
5 by redesignating subparagraphs (F) through (AA) as
6 subparagraphs (G) through (BB), respectively, and by
7 inserting after subparagraph (E) the following new
8 subparagraph:

9 “(F) subsections (b) and (d) of section
10 6043A (relating to returns relating to taxable
11 mergers and acquisitions).”.

12 (c) CLERICAL AMENDMENT.—The table of sections for
13 subpart B of part III of subchapter A of chapter 61 is
14 amended by inserting after the item relating to section 6043
15 the following new item:

 “Sec. 6043A. Returns relating to taxable mergers and acqui-
 sitions.”.

16 (d) EFFECTIVE DATE.—The amendments made by this
17 section shall apply to acquisitions after the date of the en-
18 actment of this Act.

19 **Subtitle E—International Tax**

20 **SEC. 451. CLARIFICATION OF BANKING BUSINESS FOR PUR-** 21 **POSES OF DETERMINING INVESTMENT OF** 22 **EARNINGS IN UNITED STATES PROPERTY.**

23 (a) IN GENERAL.—Subparagraph (A) of section
24 956(c)(2) is amended to read as follows:

1 “(A) obligations of the United States,
2 money, or deposits with—

3 “(i) any bank (as defined by section
4 2(c) of the Bank Holding Company Act of
5 1956 (12 U.S.C. 1841(c)), without regard to
6 subparagraphs (C) and (G) of paragraph
7 (2) of such section), or

8 “(ii) any corporation not described in
9 clause (i) with respect to which a bank
10 holding company (as defined by section 2(a)
11 of such Act) or financial holding company
12 (as defined by section 2(p) of such Act)
13 owns directly or indirectly more than 80
14 percent by vote or value of the stock of such
15 corporation;”.

16 (b) *EFFECTIVE DATE.*—The amendment made by this
17 section shall take effect on the date of the enactment of this
18 Act.

19 **SEC. 452. PROHIBITION ON NONRECOGNITION OF GAIN**
20 **THROUGH COMPLETE LIQUIDATION OF**
21 **HOLDING COMPANY.**

22 (a) *IN GENERAL.*—Section 332 is amended by adding
23 at the end the following new subsection:

24 “(d) *RECOGNITION OF GAIN ON LIQUIDATION OF CER-*
25 **TAIN HOLDING COMPANIES.**—

1 “(1) *IN GENERAL.*—*In the case of any distribu-*
 2 *tion to a foreign corporation in complete liquidation*
 3 *of an applicable holding company—*

4 “(A) *subsection (a) and section 331 shall*
 5 *not apply to such distribution, and*

6 “(B) *such distribution shall be treated as a*
 7 *distribution to which section 301 applies.*

8 “(2) *APPLICABLE HOLDING COMPANY.*—*For pur-*
 9 *poses of this subsection—*

10 “(A) *IN GENERAL.*—*The term ‘applicable*
 11 *holding company’ means any domestic corpora-*
 12 *tion—*

13 “(i) *which is a common parent of an*
 14 *affiliated group,*

15 “(ii) *stock of which is directly owned*
 16 *by the distributee foreign corporation,*

17 “(iii) *substantially all of the assets of*
 18 *which consist of stock in other members of*
 19 *such affiliated group, and*

20 “(iv) *which has not been in existence*
 21 *at all times during the 5 years immediately*
 22 *preceding the date of the liquidation.*

23 “(B) *AFFILIATED GROUP.*—*For purposes of*
 24 *this subsection, the term ‘affiliated group’ has the*
 25 *meaning given such term by section 1504(a)*

1 *(without regard to paragraphs (2) and (4) of sec-*
 2 *tion 1504(b)).*

3 “(3) *COORDINATION WITH SUBPART F.—If the*
 4 *distributee of a distribution described in paragraph*
 5 *(1) is a controlled foreign corporation (as defined in*
 6 *section 957), then notwithstanding paragraph (1) or*
 7 *subsection (a), such distribution shall be treated as a*
 8 *distribution to which section 331 applies.*

9 “(4) *REGULATIONS.—The Secretary shall pro-*
 10 *vide such regulations as appropriate to prevent the*
 11 *abuse of this subsection, including regulations which*
 12 *provide, for the purposes of clause (iv) of paragraph*
 13 *(2)(A), that a corporation is not in existence for any*
 14 *period unless it is engaged in the active conduct of a*
 15 *trade or business or owns a significant ownership in-*
 16 *terest in another corporation so engaged.”.*

17 “(b) *EFFECTIVE DATE.—The amendment made by this*
 18 *section shall apply to distributions in complete liquidation*
 19 *occurring on or after the date of the enactment of this Act.*

20 **SEC. 453. PREVENTION OF MISMATCHING OF INTEREST**
 21 **AND ORIGINAL ISSUE DISCOUNT DEDUC-**
 22 **TIONS AND INCOME INCLUSIONS IN TRANS-**
 23 **ACTIONS WITH RELATED FOREIGN PERSONS.**

24 “(a) *ORIGINAL ISSUE DISCOUNT.—Section 163(e)(3)*
 25 *(relating to special rule for original issue discount on obli-*

1 gation held by related foreign person) is amended by redес-
 2 ignating subparagraph (B) as subparagraph (C) and by in-
 3 serting after subparagraph (A) the following new subpara-
 4 graph:

5 “(B) SPECIAL RULE FOR CERTAIN FOREIGN
 6 ENTITIES.—

7 “(i) IN GENERAL.—In the case of any
 8 debt instrument having original issue dis-
 9 count which is held by a related foreign per-
 10 son which is a foreign personal holding
 11 company (as defined in section 552), a con-
 12 trolled foreign corporation (as defined in
 13 section 957), or a passive foreign investment
 14 company (as defined in section 1297), a de-
 15 duction shall be allowable to the issuer with
 16 respect to such original issue discount for
 17 any taxable year before the taxable year in
 18 which paid only to the extent such original
 19 issue discount is included during such prior
 20 taxable year in the gross income of a United
 21 States person who owns (within the mean-
 22 ing of section 958(a)) stock in such corpora-
 23 tion.

24 “(ii) SECRETARIAL AUTHORITY.—The
 25 Secretary may by regulation exempt trans-

1 actions from the application of clause (i),
 2 including any transaction which is entered
 3 into by a payor in the ordinary course of
 4 a trade or business in which the payor is
 5 predominantly engaged.”.

6 (b) *INTEREST AND OTHER DEDUCTIBLE AMOUNTS.*—

7 Section 267(a)(3) is amended—

8 (1) by striking “The Secretary” and inserting:

9 “(A) *IN GENERAL.*—The Secretary”, and

10 (2) by adding at the end the following new sub-
 11 paragraph:

12 “(B) *SPECIAL RULE FOR CERTAIN FOREIGN*
 13 *ENTITIES.*—

14 “(i) *IN GENERAL.*—Notwithstanding
 15 subparagraph (A), in the case of any
 16 amount payable to a foreign personal hold-
 17 ing company (as defined in section 552), a
 18 controlled foreign corporation (as defined in
 19 section 957), or a passive foreign investment
 20 company (as defined in section 1297), a de-
 21 duction shall be allowable to the payor with
 22 respect to such amount for any taxable year
 23 before the taxable year in which paid only
 24 to the extent such amount is included dur-
 25 ing such prior taxable year in the gross in-

1 come of a United States person who owns
2 (within the meaning of section 958(a)) stock
3 in such corporation.

4 “(ii) *SECRETARIAL AUTHORITY.*—The
5 Secretary may by regulation exempt trans-
6 actions from the application of clause (i),
7 including any transaction which is entered
8 into by a payor in the ordinary course of
9 a trade or business in which the payor is
10 predominantly engaged and in which the
11 payment of the accrued amounts occurs
12 within 8½ months after accrual or within
13 such other period as the Secretary may pre-
14 scribe.”.

15 (c) *EFFECTIVE DATE.*—The amendments made by this
16 section shall apply to payments accrued on or after the date
17 of the enactment of this Act.

18 **SEC. 454. EFFECTIVELY CONNECTED INCOME TO INCLUDE**
19 **CERTAIN FOREIGN SOURCE INCOME.**

20 (a) *IN GENERAL.*—Section 864(c)(4)(B) (relating to
21 treatment of income from sources without the United States
22 as effectively connected income) is amended by adding at
23 the end the following new flush sentence:

24 “Any income or gain which is equivalent to any
25 item of income or gain described in clause (i),

1 (ii), or (iii) shall be treated in the same manner
2 as such item for purposes of this subparagraph.”.

3 (b) *EFFECTIVE DATE.*—The amendment made by this
4 section shall apply to taxable years beginning after the date
5 of the enactment of this Act.

6 **SEC. 455. RECAPTURE OF OVERALL FOREIGN LOSSES ON**
7 **SALE OF CONTROLLED FOREIGN CORPORA-**
8 **TION.**

9 (a) *IN GENERAL.*—Section 904(f)(3) (relating to dis-
10 positions) is amending by adding at the end the following
11 new subparagraph:

12 “(D) *APPLICATION TO DISPOSITIONS OF*
13 *STOCK IN CONTROLLED FOREIGN CORPORA-*
14 *TIONS.*—In the case of any disposition by a tax-
15 payer of any share of stock in a controlled for-
16 eign corporation (as defined in section 957), this
17 paragraph shall apply to such disposition in the
18 same manner as if it were a disposition of prop-
19 erty described in subparagraph (A), except that
20 the exception contained in subparagraph (C)(i)
21 shall not apply.”.

22 (b) *EFFECTIVE DATE.*—The amendment made by this
23 section shall apply to dispositions after the date of the en-
24 actment of this Act.

1 **SEC. 456. MINIMUM HOLDING PERIOD FOR FOREIGN TAX**
 2 **CREDIT ON WITHHOLDING TAXES ON INCOME**
 3 **OTHER THAN DIVIDENDS.**

4 (a) *IN GENERAL.*—Section 901 is amended by redesi-
 5 gnating subsection (l) as subsection (m) and by inserting
 6 after subsection (k) the following new subsection:

7 “(l) *MINIMUM HOLDING PERIOD FOR WITHHOLDING*
 8 *TAXES ON GAIN AND INCOME OTHER THAN DIVIDENDS*
 9 *ETC.*—

10 “(1) *IN GENERAL.*—In no event shall a credit be
 11 allowed under subsection (a) for any withholding tax
 12 (as defined in subsection (k)) on any item of income
 13 or gain with respect to any property if—

14 “(A) such property is held by the recipient
 15 of the item for 15 days or less during the 30-day
 16 period beginning on the date which is 15 days
 17 before the date on which the right to receive pay-
 18 ment of such item arises, or

19 “(B) to the extent that the recipient of the
 20 item is under an obligation (whether pursuant to
 21 a short sale or otherwise) to make related pay-
 22 ments with respect to positions in substantially
 23 similar or related property.

24 This paragraph shall not apply to any dividend to
 25 which subsection (k) applies.

1 “(2) *EXCEPTION FOR TAXES PAID BY DEAL-*
2 *ERS.—*

3 “(A) *IN GENERAL.—*Paragraph (1) shall
4 not apply to any qualified tax with respect to
5 any property held in the active conduct in a for-
6 eign country of a business as a dealer in such
7 property.

8 “(B) *QUALIFIED TAX.—*For purposes of sub-
9 paragraph (A), the term ‘qualified tax’ means a
10 tax paid to a foreign country (other than the for-
11 eign country referred to in subparagraph (A))
12 if—

13 “(i) the item to which such tax is at-
14 tributable is subject to taxation on a net
15 basis by the country referred to in subpara-
16 graph (A), and

17 “(ii) such country allows a credit
18 against its net basis tax for the full amount
19 of the tax paid to such other foreign coun-
20 try.

21 “(C) *DEALER.—*For purposes of subpara-
22 graph (A), the term ‘dealer’ means—

23 “(i) with respect to a security, any
24 person to whom paragraphs (1) and (2) of
25 subsection (k) would not apply by reason of

1 paragraph (4) thereof if such security were
2 stock, and

3 “(ii) with respect to any other prop-
4 erty, any person with respect to whom such
5 property is described in section 1221(a)(1).

6 “(D) REGULATIONS.—The Secretary may
7 prescribe such regulations as may be appropriate
8 to carry out this paragraph, including regula-
9 tions to prevent the abuse of the exception pro-
10 vided by this paragraph and to treat other taxes
11 as qualified taxes.

12 “(3) EXCEPTIONS.—The Secretary may by regu-
13 lation provide that paragraph (1) shall not apply to
14 property where the Secretary determines that the ap-
15 plication of paragraph (1) to such property is not
16 necessary to carry out the purposes of this subsection.

17 “(4) CERTAIN RULES TO APPLY.—Rules similar
18 to the rules of paragraphs (5), (6), and (7) of sub-
19 section (k) shall apply for purposes of this subsection.

20 “(5) DETERMINATION OF HOLDING PERIOD.—
21 Holding periods shall be determined for purposes of
22 this subsection without regard to section 1235 or any
23 similar rule.”

1 (b) *CONFORMING AMENDMENT.*—*The heading of sub-*
 2 *section (k) of section 901 is amended by inserting “ON DIVI-*
 3 *DENDS” after “TAXES”.*

4 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 5 *section shall apply to amounts paid or accrued more than*
 6 *30 days after the date of the enactment of this Act.*

7 ***Subtitle F—Other Revenue***
 8 ***Provisions***

9 ***PART I—FINANCIAL INSTRUMENTS***

10 ***SEC. 461. TREATMENT OF STRIPPED INTERESTS IN BOND***
 11 ***AND PREFERRED STOCK FUNDS, ETC.***

12 (a) *IN GENERAL.*—*Section 1286 (relating to tax treat-*
 13 *ment of stripped bonds) is amended by redesignating sub-*
 14 *section (f) as subsection (g) and by inserting after sub-*
 15 *section (e) the following new subsection:*

16 “(f) *TREATMENT OF STRIPPED INTERESTS IN BOND*
 17 *AND PREFERRED STOCK FUNDS, ETC.*—*In the case of an*
 18 *account or entity substantially all of the assets of which*
 19 *consist of bonds, preferred stock, or a combination thereof,*
 20 *the Secretary may by regulations provide that rules similar*
 21 *to the rules of this section and 305(e), as appropriate, shall*
 22 *apply to interests in such account or entity to which (but*
 23 *for this subsection) this section or section 305(e), as the case*
 24 *may be, would not apply.”*

1 (b) *CROSS REFERENCE.*—Subsection (e) of section 305
 2 is amended by adding at the end the following new para-
 3 graph:

4 “(7) *CROSS REFERENCE.*—

*“For treatment of stripped interests in certain ac-
 counts or entities holding preferred stock, see section
 1286(f).”*

5 (c) *EFFECTIVE DATE.*—The amendments made by this
 6 section shall apply to purchases and dispositions after the
 7 date of the enactment of this Act.

8 **SEC. 462. APPLICATION OF EARNINGS STRIPPING RULES TO**
 9 **PARTNERSHIPS AND S CORPORATIONS.**

10 (a) *IN GENERAL.*—Section 168(j) (relating to limita-
 11 tion on deduction for interest on certain indebtedness) is
 12 amended by redesignating paragraph (8) as paragraph (9)
 13 and by inserting after paragraph (7) the following new
 14 paragraph:

15 “(8) *APPLICATION TO PARTNERSHIPS AND S COR-*
 16 *PORATIONS.*—

17 “(A) *IN GENERAL.*—This subsection shall
 18 apply to partnerships and S corporations in the
 19 same manner as it applies to C corporations.

20 “(B) *ALLOCATIONS TO CERTAIN CORPORATE*
 21 *PARTNERS.*—If a C corporation is a partner in
 22 a partnership—

23 “(i) the corporation’s allocable share of
 24 indebtedness and interest income of the

1 partnership shall be taken into account in
2 applying this subsection to the corporation,
3 and

4 “(ii) if a deduction is not disallowed
5 under this subsection with respect to any
6 interest expense of the partnership, this sub-
7 section shall be applied separately in deter-
8 mining whether a deduction is allowable to
9 the corporation with respect to the corpora-
10 tion’s allocable share of such interest ex-
11 pense.”.

12 (b) *EFFECTIVE DATE.*—The amendments made by this
13 section shall apply to taxable years beginning after the date
14 of the enactment of this Act.

15 **SEC. 463. RECOGNITION OF CANCELLATION OF INDEBTED-**
16 **NESS INCOME REALIZED ON SATISFACTION**
17 **OF DEBT WITH PARTNERSHIP INTEREST.**

18 (a) *IN GENERAL.*—Paragraph (8) of section 108(e) (re-
19 lating to general rules for discharge of indebtedness (includ-
20 ing discharges not in title 11 cases or insolvency)) is
21 amended to read as follows:

22 “(8) *INDEBTEDNESS SATISFIED BY CORPORATE*
23 *STOCK OR PARTNERSHIP INTEREST.*—For purposes of
24 determining income of a debtor from discharge of in-
25 debtedness, if—

1 “(A) a debtor corporation transfers stock, or

2 “(B) a debtor partnership transfers a cap-

3 ital or profits interest in such partnership,

4 to a creditor in satisfaction of its recourse or non-

5 recourse indebtedness, such corporation or partnership

6 shall be treated as having satisfied the indebtedness

7 with an amount of money equal to the fair market

8 value of the stock or interest. In the case of any part-

9 nership, any discharge of indebtedness income recog-

10 nized under this paragraph shall be included in the

11 distributive shares of taxpayers which were the part-

12 ners in the partnership immediately before such dis-

13 charge.”.

14 (b) *EFFECTIVE DATE.*—The amendment made by this

15 section shall apply with respect to cancellations of indebted-

16 ness occurring on or after the date of the enactment of this

17 Act.

18 **SEC. 464. MODIFICATION OF STRADDLE RULES.**

19 (a) *RULES RELATING TO IDENTIFIED STRADDLES.*—

20 (1) *IN GENERAL.*—Subparagraph (A) of section

21 1092(a)(2) (relating to special rule for identified

22 straddles) is amended to read as follows:

23 “(A) *IN GENERAL.*—In the case of any

24 straddle which is an identified straddle—

1 “(i) paragraph (1) shall not apply
2 with respect to identified positions com-
3 prising the identified straddle,

4 “(ii) if there is any loss with respect to
5 any identified position of the identified
6 straddle, the basis of each of the identified
7 offsetting positions in the identified straddle
8 shall be increased by an amount which
9 bears the same ratio to the loss as the unrec-
10 ognized gain with respect to such offsetting
11 position bears to the aggregate unrecognized
12 gain with respect to all such offsetting posi-
13 tions, and

14 “(iii) any loss described in clause (ii)
15 shall not otherwise be taken into account for
16 purposes of this title.”.

17 (2) IDENTIFIED STRADDLE.—Section
18 1092(a)(2)(B) (defining identified straddle) is amend-
19 ed—

20 (A) by striking clause (ii) and inserting the
21 following:

22 “(ii) to the extent provided by regula-
23 tions, the value of each position of which (in
24 the hands of the taxpayer immediately be-
25 fore the creation of the straddle) is not less

1 *than the basis of such position in the hands*
 2 *of the taxpayer at the time the straddle is*
 3 *created, and", and*

4 *(B) by adding at the end the following new*
 5 *flush sentence:*

6 *"The Secretary shall prescribe regulations which*
 7 *specify the proper methods for clearly identifying*
 8 *a straddle as an identified straddle (and the po-*
 9 *sitions comprising such straddle), which specify*
 10 *the rules for the application of this section for a*
 11 *taxpayer which fails to properly identify the po-*
 12 *sitions of an identified straddle, and which*
 13 *specify the ordering rules in cases where a tax-*
 14 *payer disposes of less than an entire position*
 15 *which is part of an identified straddle."*

16 *(3) UNRECOGNIZED GAIN.—Section 1092(a)(3)*
 17 *(defining unrecognized gain) is amended by redesign-*
 18 *ating subparagraph (B) as subparagraph (C) and*
 19 *by inserting after subparagraph (A) the following new*
 20 *subparagraph:*

21 *"(B) SPECIAL RULE FOR IDENTIFIED*
 22 *STRADDLES.—For purposes of paragraph*
 23 *(2)(A)(ii), the unrecognized gain with respect to*
 24 *any identified offsetting position shall be the ex-*
 25 *cess of the fair market value of the position at*

1 *the time of the determination over the fair mar-*
 2 *ket value of the position at the time the taxpayer*
 3 *identified the position as a position in an identi-*
 4 *fied straddle.”*

5 (4) *CONFORMING AMENDMENT.—Section*
 6 *1092(c)(2) is amended by striking subparagraph (B)*
 7 *and by redesignating subparagraph (C) as subpara-*
 8 *graph (B).*

9 (b) *PHYSICALLY SETTLED POSITIONS.—Section*
 10 *1092(d) (relating to definitions and special rules) is amend-*
 11 *ed by adding at the end the following new paragraph:*

12 *“(8) SPECIAL RULES FOR PHYSICALLY SETTLED*
 13 *POSITIONS.—For purposes of subsection (a), if a tax-*
 14 *payer settles a position which is part of a straddle by*
 15 *delivering property to which the position relates (and*
 16 *such position, if terminated, would result in a real-*
 17 *ization of a loss), then such taxpayer shall be treated*
 18 *as if such taxpayer—*

19 *“(A) terminated the position for its fair*
 20 *market value immediately before the settlement,*
 21 *and*

22 *“(B) sold the property so delivered by the*
 23 *taxpayer at its fair market value.”.*

24 (c) *REPEAL OF STOCK EXCEPTION.—*

1 (1) *IN GENERAL.*—Section 1092(d)(3) is re-
2 pealed.

3 (2) *CONFORMING AMENDMENT.*—Section
4 1258(d)(1) is amended by striking “; except that the
5 term ‘personal property’ shall include stock”.

6 (d) *REPEAL OF QUALIFIED COVERED CALL EXCEP-*
7 *TION.*—Section 1092(c)(4) is amended by adding at the end
8 the following new subparagraph:

9 “(I) *TERMINATION.*—This paragraph shall
10 not apply to any position established on or after
11 the date of the enactment of this subparagraph.”.

12 (e) *EFFECTIVE DATE.*—The amendments made by this
13 section shall apply to positions established on or after the
14 date of the enactment of this Act.

15 **SEC. 465. DENIAL OF INSTALLMENT SALE TREATMENT FOR**
16 **ALL READILY TRADEABLE DEBT.**

17 (a) *IN GENERAL.*—Section 453(f)(4)(B) (relating to
18 purchaser evidences of indebtedness payable on demand or
19 readily tradeable) is amended by striking “is issued by a
20 corporation or a government or political subdivision thereof
21 and”.

22 (b) *EFFECTIVE DATE.*—The amendment made by this
23 section shall apply to sales occurring on or after the date
24 of the enactment of this Act.

1 **PART II—CORPORATIONS AND PARTNERSHIPS**

2 **SEC. 466. MODIFICATION OF TREATMENT OF TRANSFERS**
3 **TO CREDITORS IN DIVISIVE REORGANIZA-**
4 **TIONS.**

5 (a) *IN GENERAL.*—Section 361(b)(3) (relating to treat-
6 ment of transfers to creditors) is amended by adding at the
7 end the following new sentence: “In the case of a reorganiza-
8 tion described in section 368(a)(1)(D) with respect to which
9 stock or securities of the corporation to which the assets are
10 transferred are distributed in a transaction which qualifies
11 under section 355, this paragraph shall apply only to the
12 extent that the sum of the money and the fair market value
13 of other property transferred to such creditors does not ex-
14 ceed the adjusted bases of such assets transferred.”.

15 (b) *LIABILITIES IN EXCESS OF BASIS.*—Section
16 357(c)(1)(B) is amended by inserting “with respect to
17 which stock or securities of the corporation to which the as-
18 sets are transferred are distributed in a transaction which
19 qualifies under section 355” after “section 368(a)(1)(D)”.

20 (c) *EFFECTIVE DATE.*—The amendments made by this
21 section shall apply to transfers of money or other property,
22 or liabilities assumed, in connection with a reorganization
23 occurring on or after the date of the enactment of this Act.

1 **SEC. 467. CLARIFICATION OF DEFINITION OF NON-**
 2 **QUALIFIED PREFERRED STOCK.**

3 (a) *IN GENERAL.*—Section 351(g)(3)(A) is amended
 4 by adding at the end the following: “Stock shall not be treat-
 5 ed as participating in corporate growth to any significant
 6 extent unless there is a real and meaningful likelihood of
 7 the shareholder actually participating in the earnings and
 8 growth of the corporation.”.

9 (b) *EFFECTIVE DATE.*—The amendment made by this
 10 section shall apply to transactions after May 14, 2003.

11 **SEC. 468. MODIFICATION OF DEFINITION OF CONTROLLED**
 12 **GROUP OF CORPORATIONS.**

13 (a) *IN GENERAL.*—Section 1563(a)(2) (relating to
 14 brother-sister controlled group) is amended by striking
 15 “possessing—” and all that follows through “(B)” and in-
 16 serting “possessing”.

17 (b) *APPLICATION OF EXISTING RULES TO OTHER*
 18 *CODE PROVISIONS.*—Section 1563(f) (relating to other defi-
 19 nitions and rules) is amended by adding at the end the
 20 following new paragraph:

21 “(5) *BROTHER-SISTER CONTROLLED GROUP DEF-*
 22 *INITION FOR PROVISIONS OTHER THAN THIS PART.*—

23 “(A) *IN GENERAL.*—Except as specifically
 24 provided in an applicable provision, subsection
 25 (a)(2) shall be applied to an applicable provision
 26 as if it read as follows:

1 ‘(2) *BROTHER-SISTER CONTROLLED GROUP.*—

2 *Two or more corporations if 5 or fewer persons who*
 3 *are individuals, estates, or trusts own (within the*
 4 *meaning of subsection (d)(2) stock possessing—*

5 ‘(A) *at least 80 percent of the total com-*
 6 *bined voting power of all classes of stock entitled*
 7 *to vote, or at least 80 percent of the total value*
 8 *of shares of all classes of stock, of each corpora-*
 9 *tion, and*

10 ‘(B) *more than 50 percent of the total com-*
 11 *bined voting power of all classes of stock entitled*
 12 *to vote or more than 50 percent of the total value*
 13 *of shares of all classes of stock of each corpora-*
 14 *tion, taking into account the stock ownership of*
 15 *each such person only to the extent such stock*
 16 *ownership is identical with respect to each such*
 17 *corporation.’*

18 “(B) *APPLICABLE PROVISION.*—*For pur-*
 19 *poses of this paragraph, an applicable provision*
 20 *is any provision of law (other than this part)*
 21 *which incorporates the definition of controlled*
 22 *group of corporations under subsection (a).”*

23 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 24 *section shall apply to taxable years beginning after the date*
 25 *of the enactment of this Act.*

1 **SEC. 469. MANDATORY BASIS ADJUSTMENTS IN CONNEC-**
 2 **TION WITH PARTNERSHIP DISTRIBUTIONS**
 3 **AND TRANSFERS OF PARTNERSHIP INTER-**
 4 **ESTS.**

5 (a) *IN GENERAL.*—Section 754 is repealed.

6 (b) *ADJUSTMENT TO BASIS OF UNDISTRIBUTED PART-*
 7 *NERSHIP PROPERTY.*—Section 734 is amended—

8 (1) by striking “, with respect to which the elec-
 9 tion provided in section 754 is in effect,” in the mat-
 10 ter preceding paragraph (1) of subsection (b),

11 (2) by striking “(as adjusted by section 732(d))”
 12 both places it appears in subsection (b),

13 (3) by striking the last sentence of subsection (b),

14 (4) by striking subsection (a) and by redesign-
 15 ating subsections (b) and (c) as subsections (a) and
 16 (b), respectively, and

17 (5) by striking “**OPTIONAL**” in the heading.

18 (c) *ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-*
 19 *ERTY.*—Section 743 is amended—

20 (1) by striking “with respect to which the elec-
 21 tion provided in section 754 is in effect” in the mat-
 22 ter preceding paragraph (1) of subsection (b),

23 (2) by striking subsection (a) and by redesign-
 24 ating subsections (b) and (c) as subsections (a) and
 25 (b), respectively,

1 (3) by adding at the end the following new sub-
2 section:

3 “(c) *ELECTION TO ADJUST BASIS FOR TRANSFERS*
4 *UPON DEATH OF PARTNER.*—Subsection (a) shall not
5 apply and no adjustments shall be made in the case of any
6 transfer of an interest in a partnership upon the death of
7 a partner unless an election to do so is made by the partner-
8 ship. Such an election shall apply with respect to all such
9 transfers of interests in the partnership. Any election under
10 section 754 in effect on the date of the enactment of this
11 subsection shall constitute an election made under this sub-
12 section. Such election may be revoked by the partnership,
13 subject to such limitations as may be provided by regula-
14 tions prescribed by the Secretary.”, and

15 (4) by striking “*OPTIONAL*” in the heading.

16 (d) *CONFORMING AMENDMENTS.*—

17 (1) Subsection (d) of section 732 is repealed.

18 (2) Section 755(a) is amended—

19 (A) by striking “section 734(b) (relating to
20 the optional adjustment” and inserting “section
21 734(a) (relating to the adjustment”, and

22 (B) by striking “section 743(b) (relating to
23 the optional adjustment” and inserting “section
24 743(a) (relating to the adjustment”.

1 (3) Section 761(e)(2) is amended by striking
2 “optional”.

3 (4) Section 774(a) is amended by striking
4 “743(b)” both places it appears and inserting
5 “743(a)”.

6 (5) The item relating to section 734 in the table
7 of sections for subpart B of part II of subchapter K
8 of chapter 1 is amended by striking “Optional”.

9 (6) The item relating to section 743 in the table
10 of sections for subpart C of part II of subchapter K
11 of chapter 1 is amended by striking “Optional”.

12 (e) *EFFECTIVE DATES.*—

13 (1) *IN GENERAL.*—Except as provided in para-
14 graph (2), the amendments made by this section shall
15 apply to transfers and distributions made after the
16 date of the enactment of this Act.

17 (2) *REPEAL OF SECTION 732(d).*—The amend-
18 ments made by subsections (b)(2) and (d)(1) shall
19 apply to—

20 (A) except as provided in subparagraph
21 (B), transfers made after the date of the enact-
22 ment of this Act, and

23 (B) in the case of any transfer made on or
24 before such date to which section 732(d) applies,

1 *distributions made after the date which is 2*
 2 *years after such date of enactment.*

3 **PART III—DEPRECIATION AND AMORTIZATION**

4 **SEC. 471. EXTENSION OF AMORTIZATION OF INTANGIBLES**
 5 **TO SPORTS FRANCHISES.**

6 (a) *IN GENERAL.*—Section 197(e) (relating to excep-
 7 *tions to definition of section 197 intangible)* is amended
 8 *by striking paragraph (6) and by redesignating paragraphs*
 9 *(7) and (8) as paragraphs (6) and (7), respectively.*

10 (b) *CONFORMING AMENDMENTS.*—

11 (1)(A) *Section 1056 (relating to basis limitation*
 12 *for player contracts transferred in connection with*
 13 *the sale of a franchise) is repealed.*

14 (B) *The table of sections for part IV of sub-*
 15 *chapter O of chapter 1 is amended by striking the*
 16 *item relating to section 1056.*

17 (2) *Section 1245(a) (relating to gain from dis-*
 18 *position of certain depreciable property) is amended*
 19 *by striking paragraph (4).*

20 (3) *Section 1253 (relating to transfers of fran-*
 21 *chises, trademarks, and trade names) is amended by*
 22 *striking subsection (e).*

23 (c) *EFFECTIVE DATES.*—

24 (1) *IN GENERAL.*—*Except as provided in para-*
 25 *graph (2), the amendments made by this section shall*

1 apply to property acquired after the date of the enact-
2 ment of this Act.

3 (2) SECTION 1245.—The amendment made by
4 subsection (b)(2) shall apply to franchises acquired
5 after the date of the enactment of this Act.

6 **SEC. 472. SERVICE CONTRACTS TREATED IN SAME MANNER**
7 **AS LEASES FOR RULES RELATING TO TAX-EX-**
8 **EMPT USE PROPERTY.**

9 (a) *IN GENERAL.*—Section 168(h)(7) (defining lease)
10 is amended by adding at the end the following: “Such term
11 shall also include any service contract or other similar ar-
12 rangement.”.

13 (b) *LEASE TERM.*—Section 168(i)(3) (relating to lease
14 term) is amended by adding at the end the following new
15 subparagraph:

16 “(C) *SPECIAL RULE FOR SERVICE CON-*
17 *TRACTS.*—In the case of any service contract or
18 other similar arrangement treated as a lease
19 under subsection (h)(7), the lease term shall be
20 determined in the same manner as a lease.”.

21 (c) **CONFORMING AMENDMENTS.**—Section
22 168(g)(3)(A) is amended—

23 (1) by inserting “(as defined in subsection
24 (h)(7)” after “lease” the first place it appears, and

1 (2) by inserting “(as determined under sub-
2 section (i)(3))” after “term”.

3 (d) *EFFECTIVE DATE.*—The amendments made by this
4 section shall apply to leases and service contracts or other
5 similar arrangements entered into after the date of the en-
6 actment of this Act.

7 **SEC. 473. CLASS LIVES FOR UTILITY GRADING COSTS.**

8 (a) *GAS UTILITY PROPERTY.*—Section 168(e)(3)(E)
9 (defining 15-year property) is amended by striking “and”
10 at the end of clause (ii), by striking the period at the end
11 of clause (iii) and inserting “, and”, and by adding at the
12 end the following new clause:

13 “(iv) initial clearing and grading land
14 improvements with respect to gas utility
15 property.”.

16 (b) *ELECTRIC UTILITY PROPERTY.*—Section 168(e)(3)
17 is amended by adding at the end the following new subpara-
18 graph:

19 “(F) 20-YEAR PROPERTY.—The term ‘20-
20 year property’ means initial clearing and grad-
21 ing land improvements with respect to any elec-
22 tric utility transmission and distribution
23 plant.”.

24 (c) *CONFORMING AMENDMENTS.*—The table contained
25 in section 168(g)(3)(B) is amended—

1 (1) by inserting "or (E)(iv)" after "(E)(iii)",

2 and

3 (2) by adding at the end the following new item:

"(F) 25".

4 (d) *EFFECTIVE DATE.*—The amendments made by this
5 section shall apply to property placed in service after the
6 date of the enactment of this Act.

7 **SEC. 474. EXPANSION OF LIMITATION ON DEPRECIATION**

8 **OF CERTAIN PASSENGER AUTOMOBILES.**

9 (a) *IN GENERAL.*—Section 179(b) (relating to limita-
10 tions) is amended by adding at the end the following new
11 paragraph:

12 "(6) *LIMITATION ON COST TAKEN INTO ACCOUNT*
13 *FOR CERTAIN PASSENGER VEHICLES.*—

14 "(A) *IN GENERAL.*—The cost of any sport
15 utility vehicle for any taxable year which may
16 be taken into account under this section shall not
17 exceed \$25,000.

18 "(B) *SPORT UTILITY VEHICLE.*—For pur-
19 poses of subparagraph (A)—

20 "(i) *IN GENERAL.*—The term 'sport
21 utility vehicle' means any 4-wheeled vehicle
22 which—

23 "(I) is manufactured primarily
24 for use on public streets, roads, and
25 highways,

1 “(II) is not subject to section
2 280F, and

3 “(III) is rated at not more than
4 14,000 pounds gross vehicle weight.

5 “(ii) CERTAIN VEHICLES EXCLUDED.—
6 Such term does not include any vehicle
7 which—

8 “(I) does not have the primary
9 load carrying device or container at-
10 tached,

11 “(II) has a seating capacity of
12 more than 12 individuals,

13 “(III) is designed for more than 9
14 individuals in seating rearward of the
15 driver's seat,

16 “(IV) is equipped with an open
17 cargo area, or a covered box not read-
18 ily accessible from the passenger com-
19 partment, of at least 72.0 inches in in-
20 terior length, or

21 “(V) has an integral enclosure,
22 fully enclosing the driver compartment
23 and load carrying device, does not have
24 seating rearward of the driver's seat,
25 and has no body section protruding

1 more than 30 inches ahead of the lead-
2 ing edge of the windshield.”.

3 (c) *EFFECTIVE DATE.*—The amendments made by this
4 section shall apply to property placed in service after the
5 date of the enactment of this Act.

6 **SEC. 475. CONSISTENT AMORTIZATION OF PERIODS FOR IN-**
7 **TANGIBLES.**

8 (a) *START-UP EXPENDITURES.*—

9 (1) *ALLOWANCE OF DEDUCTION.*—Paragraph (1)
10 of section 195(b) (relating to start-up expenditures) is
11 amended to read as follows:

12 “(1) *ALLOWANCE OF DEDUCTION.*—If a taxpayer
13 elects the application of this subsection with respect to
14 any start-up expenditures—

15 “(A) the taxpayer shall be allowed a deduc-
16 tion for the taxable year in which the active
17 trade or business begins in an amount equal to
18 the lesser of—

19 “(i) the amount of start-up expendi-
20 tures with respect to the active trade or
21 business, or

22 “(ii) \$5,000, reduced (but not below
23 zero) by the amount by which such start-up
24 expenditures exceed \$50,000, and

1 “(B) the remainder of such start-up expend-
 2 itures shall be allowed as a deduction ratably
 3 over the 180-month period beginning with the
 4 month in which the active trade or business be-
 5 gins.”.

6 (2) CONFORMING AMENDMENT.—Subsection (b)
 7 of section 195 is amended by striking “AMORTIZE”
 8 and inserting “DEDUCT” in the heading.

9 (b) ORGANIZATIONAL EXPENDITURES.—Subsection (a)
 10 of section 248 (relating to organizational expenditures) is
 11 amended to read as follows:

12 “(a) ELECTION TO DEDUCT.—If a corporation elects
 13 the application of this subsection (in accordance with regu-
 14 lations prescribed by the Secretary) with respect to any or-
 15 ganizational expenditures—

16 “(1) the corporation shall be allowed a deduction
 17 for the taxable year in which the corporation begins
 18 business in an amount equal to the lesser of—

19 “(A) the amount of organizational expendi-
 20 tures with respect to the taxpayer, or

21 “(B) \$5,000, reduced (but not below zero) by
 22 the amount by which such organizational ex-
 23 penditures exceed \$50,000, and

24 “(2) the remainder of such organizational ex-
 25 penditures shall be allowed as a deduction ratably

1 *over the 180-month period beginning with the month*
 2 *in which the corporation begins business.”.*

3 (c) *TREATMENT OF ORGANIZATIONAL AND SYNDICA-*
 4 *TION FEES OR PARTNERSHIPS.—*

5 (1) *IN GENERAL.—*Section 709(b) (relating to
 6 *amortization of organization fees) is amended by re-*
 7 *designating paragraph (2) as paragraph (3) and by*
 8 *amending paragraph (1) to read as follows:*

9 “(1) *ALLOWANCE OF DEDUCTION.—*If a taxpayer
 10 *elects the application of this subsection (in accordance*
 11 *with regulations prescribed by the Secretary) with re-*
 12 *spect to any organizational expenses—*

13 “(A) *the taxpayer shall be allowed a deduc-*
 14 *tion for the taxable year in which the partner-*
 15 *ship begins business in an amount equal to the*
 16 *lesser of—*

17 “(i) *the amount of organizational ex-*
 18 *penses with respect to the partnership, or*

19 “(ii) *\$5,000, reduced (but not below*
 20 *zero) by the amount by which such organi-*
 21 *zational expenses exceed \$50,000, and*

22 “(B) *the remainder of such organizational*
 23 *expenses shall be allowed as a deduction ratably*
 24 *over the 180-month period beginning with the*
 25 *month in which the partnership begins business.*

1 “(2) *DISPOSITIONS BEFORE CLOSE OF AMORTI-*
 2 *ZATION PERIOD.*—*In any case in which a partnership*
 3 *is liquidated before the end of the period to which*
 4 *paragraph (1)(B) applies, any deferred expenses at-*
 5 *tributable to the partnership which were not allowed*
 6 *as a deduction by reason of this section may be de-*
 7 *ducted to the extent allowable under section 165.”.*

8 (2) *CONFORMING AMENDMENT.*—*Subsection (b)*
 9 *of section 709 is amended by striking “AMORTIZA-*
 10 *TION” and inserting “DEDUCTION” in the heading.*

11 (d) *EFFECTIVE DATE.*—*The amendments made by this*
 12 *section shall apply to amounts paid or incurred after the*
 13 *date of the enactment of this Act.*

14 **SEC. 476. LIMITATION ON DEDUCTIONS ALLOCABLE TO**
 15 **PROPERTY USED BY GOVERNMENTS OR**
 16 **OTHER TAX-EXEMPT ENTITIES.**

17 (a) *IN GENERAL.*—*Subpart C of part II of subchapter*
 18 *E of chapter 1 (relating to taxable year for which deduc-*
 19 *tions taken) is amended by adding at the end the following*
 20 *new section:*

21 **“SEC. 470. DEDUCTIONS ALLOCABLE TO PROPERTY USED**
 22 **BY GOVERNMENTS OR OTHER TAX-EXEMPT**
 23 **ENTITIES.**

24 “(a) *GENERAL RULE.*—*The aggregate amount of de-*
 25 *ductions otherwise allowable to the taxpayer with respect*

1 to tax-exempt use property for any taxable year shall not
 2 exceed the aggregate amount of income includible in gross
 3 income of the taxpayer for the taxable year with respect
 4 to such property.

5 “(b) *DISALLOWED DEDUCTION CARRIED TO NEXT*
 6 *YEAR.*—Except as otherwise provided in this section, any
 7 deduction with respect to any tax-exempt use property
 8 which is disallowed under subsection (a) shall, subject to
 9 the limitation under subsection (a), be treated as a deduc-
 10 tion with respect to such property in the next taxable year.

11 “(c) *TAX-EXEMPT USE PROPERTY.*—For purposes of
 12 this section—

13 “(1) *IN GENERAL.*—The term ‘tax-exempt use
 14 property’ has the meaning given such term by section
 15 168(h), except that such section shall be applied with-
 16 out regard to paragraphs (2)(C)(ii) and (3).

17 “(2) *SPECIAL RULES FOR SERVICE CONTRACTS*
 18 *AND SIMILAR ARRANGEMENTS.*—If tangible property
 19 is subject to a service contract or other similar ar-
 20 rangement between a taxpayer (or any related per-
 21 son) and any tax-exempt entity, such contract or ar-
 22 rangement shall be treated in the same manner as if
 23 it were a lease for purposes of determining whether
 24 such property is tax-exempt use property under para-
 25 graph (1).

1 “(d) *SPECIAL RULES.*—

2 “(1) *ALLOCABLE DEDUCTIONS.*—Subsection (a)
3 *shall apply to—*

4 “(A) *any deduction directly allocable to any*
5 *tax-exempt use property, and*

6 “(B) *a proper share of other deductions that*
7 *are not directly allocable to such property.*

8 “(2) *PROPERTY CEASING TO BE TAX-EXEMPT*
9 *USE PROPERTY.*—If property of a taxpayer ceases to
10 *be tax-exempt use property in the hands of the tax-*
11 *payer—*

12 “(A) *any unused deduction allocable to such*
13 *property under subsection (b) shall only be al-*
14 *lowable as a deduction for any taxable year to*
15 *the extent of any net income of the taxpayer allo-*
16 *cable to such property, and*

17 “(B) *any portion of such unused deduction*
18 *remaining after application of subparagraph (A)*
19 *shall, subject to the limitation of subparagraph*
20 *(A), be treated as a deduction allocable to such*
21 *property in the next taxable year.*

22 “(3) *DISPOSITION OF ENTIRE INTEREST IN*
23 *PROPERTY.*—If during the taxable year a taxpayer
24 *disposes of the taxpayer’s entire interest in tax-ex-*

1 *empt use property, rules similar to the rules of section*
2 *469(g) shall apply for purposes of this section.*

3 “(e) *REGULATIONS.*—The Secretary shall prescribe
4 such regulations as may be necessary or appropriate to
5 carry out the provisions of this section.”.

(b) *CONFORMING AMENDMENT.*—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by adding at the end the following new item:

"Sec. 470. Deductions allocable to property used by governments or other tax-exempt entities."

9 (c) *EFFECTIVE DATE.*—*The amendments made by this*
10 *section shall apply to leases and service contracts or similar*
11 *arrangements entered into after the date of the enactment*
12 *of this Act.*

13 **PART IV—ADMINISTRATIVE PROVISIONS**

14 **SEC. 481. CLARIFICATION OF RULES FOR PAYMENT OF ESTI-**
15 **MATED TAX FOR CERTAIN DEEMED ASSET**
16 **SALES.**

17 (a) IN GENERAL.—Paragraph (13) of section 338(h)
18 (relating to tax on deemed sale not taken into account for
19 estimated tax purposes) is amended by adding at the end
20 the following: “The preceding sentence shall not apply with
21 respect to a qualified stock purchase for which an election
22 is made under paragraph (10).”.

1 (b) *EFFECTIVE DATE.*—*The amendment made by sub-*
 2 *section (a) shall apply to transactions occurring after the*
 3 *date of the enactment of this Act.*

4 **SEC. 482. EXTENSION OF IRS USER FEES.**

5 (a) *IN GENERAL.*—*Section 7528(c) (relating to termi-*
 6 *nation) is amended by striking “December 31, 2004” and*
 7 *inserting “September 30, 2013”.*

8 (b) *EFFECTIVE DATE.*—*The amendment made by this*
 9 *section shall apply to requests after the date of the enact-*
 10 *ment of this Act.*

11 **SEC. 483. DOUBLING OF CERTAIN PENALTIES, FINES, AND**
 12 **INTEREST ON UNDERPAYMENTS RELATED TO**
 13 **CERTAIN OFFSHORE FINANCIAL ARRANGE-**
 14 **MENT.**

15 (a) *GENERAL RULE.*—*If—*

16 (1) *a taxpayer eligible to participate in—*

17 (A) *the Department of the Treasury’s Off-*
 18 *shore Voluntary Compliance Initiative, or*

19 (B) *the Department of the Treasury’s vol-*
 20 *untary disclosure initiative which applies to the*
 21 *taxpayer by reason of the taxpayer’s under-*
 22 *reporting of United States income tax liability*
 23 *through financial arrangements which rely on*
 24 *the use of offshore arrangements which were the*

1 *subject of the initiative described in subpara-*
 2 *graph (A), and*

3 *(2) any interest or applicable penalty is imposed*
 4 *with respect to any arrangement to which any initia-*
 5 *tive described in paragraph (1) applied or to any un-*
 6 *derpayment of Federal income tax attributable to*
 7 *items arising in connection with any arrangement*
 8 *described in paragraph (1),*
 9 *then, notwithstanding any other provision of law, the*
 10 *amount of such interest or penalty shall be equal to twice*
 11 *that determined without regard to this section.*

12 **(b) DEFINITIONS AND RULES.**—*For purposes of this*
 13 *section—*

14 **(1) APPLICABLE PENALTY.**—*The term “applica-*
 15 *ble penalty” means any penalty, addition to tax, or*
 16 *fine imposed under chapter 68 of the Internal Rev-*
 17 *enue Code of 1986.*

18 **(2) VOLUNTARY OFFSHORE COMPLIANCE INITIA-**
 19 **TIVE.**—*The term “Voluntary Offshore Compliance*
 20 *Initiative” means the program established by the De-*
 21 *partment of the Treasury in January of 2003 under*
 22 *which any taxpayer was eligible to voluntarily dis-*
 23 *close previously undisclosed income on assets placed*
 24 *in offshore accounts and accessed through credit card*
 25 *and other financial arrangements.*

1 (3) *PARTICIPATION*.—A taxpayer shall be treated
 2 as having participated in the Voluntary Offshore
 3 Compliance Initiative if the taxpayer submitted the
 4 request in a timely manner and all information re-
 5 quested by the Secretary of the Treasury or his dele-
 6 gate within a reasonable period of time following the
 7 request.

8 (c) *EFFECTIVE DATE*.—The provisions of this section
 9 shall apply to interest, penalties, additions to tax, and fines
 10 with respect to any taxable year if as of the date of the
 11 enactment of this Act, the assessment of any tax, penalty,
 12 or interest with respect to such taxable year is not prevented
 13 by the operation of any law or rule of law.

14 **SEC. 484. PARTIAL PAYMENT OF TAX LIABILITY IN INSTALL-**
 15 **MENT AGREEMENTS.**

16 (a) *IN GENERAL*.—

17 (1) Section 6159(a) (relating to authorization of
 18 agreements) is amended—

19 (A) by striking “satisfy liability for pay-
 20 ment of” and inserting “make payment on”, and

21 (B) by inserting “full or partial” after “fa-
 22 cilitate”.

23 (2) Section 6159(c) (relating to Secretary re-
 24 quired to enter into installment agreements in certain

1 cases) is amended in the matter preceding paragraph
 2 (1) by inserting "full" before "payment".

3 (b) *REQUIREMENT TO REVIEW PARTIAL PAYMENT*
 4 *AGREEMENTS EVERY TWO YEARS.*—Section 6159, as
 5 amended by this Act, is amended by redesignating sub-
 6 sections (d), (e), and (f) as subsections (e), (f), and (g), re-
 7 spectively, and inserting after subsection (c) the following
 8 new subsection:

9 "(d) *SECRETARY REQUIRED TO REVIEW INSTALL-*
 10 *MENT AGREEMENTS FOR PARTIAL COLLECTION EVERY TWO*
 11 *YEARS.*—In the case of an agreement entered into by the
 12 Secretary under subsection (a) for partial collection of a
 13 tax liability, the Secretary shall review the agreement at
 14 least once every 2 years."

15 (c) *EFFECTIVE DATE.*—The amendments made by this
 16 section shall apply to agreements entered into on or after
 17 the date of the enactment of this Act.

18 **SEC. 485. EXTENSION OF CUSTOMS USER FEES.**

19 Section 13031(j)(3) of the Consolidated Omnibus
 20 Budget Reconciliation Act of 1985 (19 U.S.C. 58c(j)(3)) is
 21 amended by striking "March 31, 2004" and inserting "Sep-
 22 tember 30, 2013".

1 **SEC. 486. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
 2 **TEREST ON POTENTIAL UNDERPAYMENTS.**

3 (a) *IN GENERAL.*—Subchapter A of chapter 67 (relat-
 4 ing to interest on underpayments) is amended by adding
 5 at the end the following new section:

6 **"SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
 7 **TEREST ON POTENTIAL UNDERPAYMENTS,**
 8 **ETC.**

9 *"(a) AUTHORITY TO MAKE DEPOSITS OTHER THAN*
 10 *AS PAYMENT OF TAX.*—A taxpayer may make a cash de-
 11 posit with the Secretary which may be used by the Sec-
 12 retary to pay any tax imposed under subtitle A or B or
 13 chapter 41, 42, 43, or 44 which has not been assessed at
 14 the time of the deposit. Such a deposit shall be made in
 15 such manner as the Secretary shall prescribe.

16 *"(b) NO INTEREST IMPOSED.*—To the extent that such
 17 deposit is used by the Secretary to pay tax, for purposes
 18 of section 6601 (relating to interest on underpayments), the
 19 tax shall be treated as paid when the deposit is made.

20 *"(c) RETURN OF DEPOSIT.*—Except in a case where
 21 the Secretary determines that collection of tax is in jeop-
 22 ardy, the Secretary shall return to the taxpayer any
 23 amount of the deposit (to the extent not used for a payment
 24 of tax) which the taxpayer requests in writing.

25 *"(d) PAYMENT OF INTEREST.*—

1 “(1) *IN GENERAL.*—For purposes of section 6611
2 *(relating to interest on overpayments), a deposit*
3 *which is returned to a taxpayer shall be treated as a*
4 *payment of tax for any period to the extent (and only*
5 *to the extent) attributable to a disputable tax for such*
6 *period. Under regulations prescribed by the Secretary,*
7 *rules similar to the rules of section 6611(b)(2) shall*
8 *apply.*

9 “(2) *DISPUTABLE TAX.*—

10 “(A) *IN GENERAL.*—For purposes of this
11 *section, the term ‘disputable tax’ means the*
12 *amount of tax specified at the time of the deposit*
13 *as the taxpayer’s reasonable estimate of the max-*
14 *imum amount of any tax attributable to disput-*
15 *able items.*

16 “(B) *SAFE HARBOR BASED ON 30-DAY LET-*
17 *TER.*—In the case of a taxpayer who has been
18 *issued a 30-day letter, the maximum amount of*
19 *tax under subparagraph (A) shall not be less*
20 *than the amount of the proposed deficiency speci-*
21 *fied in such letter.*

22 “(3) *OTHER DEFINITIONS.*—For purposes of
23 *paragraph (2)—*

1 “(A) *DISPUTABLE ITEM*.—The term ‘disput-
2 able item’ means any item of income, gain, loss,
3 deduction, or credit if the taxpayer—

4 “(i) has a reasonable basis for its
5 treatment of such item, and

6 “(ii) reasonably believes that the Sec-
7 retary also has a reasonable basis for dis-
8 allowing the taxpayer’s treatment of such
9 item.

10 “(B) *30-DAY LETTER*.—The term ‘30-day
11 letter’ means the first letter of proposed defi-
12 ciency which allows the taxpayer an opportunity
13 for administrative review in the Internal Rev-
14 enue Service Office of Appeals.

15 “(4) *RATE OF INTEREST*.—The rate of interest
16 allowable under this subsection shall be the Federal
17 short-term rate determined under section 6621(b),
18 compounded daily.

19 “(e) *USE OF DEPOSITS*.—

20 “(1) *PAYMENT OF TAX*.—Except as otherwise
21 provided by the taxpayer, deposits shall be treated as
22 used for the payment of tax in the order deposited.

23 “(2) *RETURNS OF DEPOSITS*.—Deposits shall be
24 treated as returned to the taxpayer on a last-in, first-
25 out basis.”.

1 (b) *CLERICAL AMENDMENT.*—*The table of sections for*
 2 *subchapter A of chapter 67 is amended by adding at the*
 3 *end the following new item:*

"Sec. 6603. Deposits made to suspend running of interest on potential underpayments, etc."

4 (c) *EFFECTIVE DATE.*—

5 (1) *IN GENERAL.*—*The amendments made by*
 6 *this section shall apply to deposits made after the*
 7 *date of the enactment of this Act.*

8 (2) *COORDINATION WITH DEPOSITS MADE UNDER*
 9 *REVENUE PROCEDURE 84-58.*—*In the case of an*
 10 *amount held by the Secretary of the Treasury or his*
 11 *delegate on the date of the enactment of this Act as*
 12 *a deposit in the nature of a cash bond deposit pursu-*
 13 *ant to Revenue Procedure 84-58, the date that the*
 14 *taxpayer identifies such amount as a deposit made*
 15 *pursuant to section 6603 of the Internal Revenue*
 16 *Code (as added by this Act) shall be treated as the*
 17 *date such amount is deposited for purposes of such*
 18 *section 6603.*

19 *SEC. 487. QUALIFIED TAX COLLECTION CONTRACTS.*

20 (a) *CONTRACT REQUIREMENTS.*—

21 (1) *IN GENERAL.*—*Subchapter A of chapter 64*
 22 *(relating to collection) is amended by adding at the*
 23 *end the following new section:*

1 **"SEC. 6306. QUALIFIED TAX COLLECTION CONTRACTS.**

2 “(a) *IN GENERAL.*—Nothing in any provision of law
3 shall be construed to prevent the Secretary from entering
4 into a qualified tax collection contract.

5 “(b) *QUALIFIED TAX COLLECTION CONTRACT.*—For
6 purposes of this section, the term ‘qualified tax collection
7 contract’ means any contract which—

8 “(1) is for the services of any person (other than
9 an officer or employee of the Treasury Department)—

10 “(A) to locate and contact any taxpayer
11 specified by the Secretary,

12 “(B) to request full payment from such tax-
13 payer of an amount of Federal tax specified by
14 the Secretary and, if such request cannot be met
15 by the taxpayer, to offer the taxpayer an install-
16 ment agreement providing for full payment of
17 such amount during a period not to exceed 3
18 years, and

19 “(C) to obtain financial information speci-
20 fied by the Secretary with respect to such tax-
21 payer,

22 “(2) prohibits each person providing such serv-
23 ices under such contract from committing any act or
24 omission which employees of the Internal Revenue
25 Service are prohibited from committing in the per-
26 formance of similar services,

1 “(3) prohibits subcontractors from—

2 “(A) having contacts with taxpayers,

3 “(B) providing quality assurance services,

4 and

5 “(C) composing debt collection notices, and

6 “(4) permits subcontractors to perform other
7 services only with the approval of the Secretary.

8 “(c) FEES.—The Secretary may retain and use an
9 amount not in excess of 25 percent of the amount collected
10 under any qualified tax collection contract for the costs of
11 services performed under such contract. The Secretary shall
12 keep adequate records regarding amounts so retained and
13 used. The amount credited as paid by any taxpayer shall
14 be determined without regard to this subsection.

15 “(d) NO FEDERAL LIABILITY.—The United States
16 shall not be liable for any act or omission of any person
17 performing services under a qualified tax collection con-
18 tract.

19 “(e) APPLICATION OF FAIR DEBT COLLECTION PRAC-
20 TICES ACT.—The provisions of the Fair Debt Collection
21 Practices Act (15 U.S.C. 1692 et seq.) shall apply to any
22 qualified tax collection contract, except to the extent super-
23 seded by section 6304, section 7602(c), or by any other pro-
24 vision of this title.

25 “(f) CROSS REFERENCES.—

1 “(1) For damages for certain unauthorized col-
2 lection actions by persons performing services under
3 a qualified tax collection contract, see section 7433A.

4 “(2) For application of Taxpayer Assistance Or-
5 ders to persons performing services under a qualified
6 tax collection contract, see section 7811(a)(4).”.

7 (2) CONFORMING AMENDMENTS.—

8 (A) Section 7809(a) is amended by insert-
9 ing “6306,” before “7651”.

10 (B) The table of sections for subchapter A of
11 chapter 64 is amended by adding at the end the
12 following new item:

 “Sec. 6306. Qualified Tax Collection Contracts.”.

13 (b) CIVIL DAMAGES FOR CERTAIN UNAUTHORIZED
14 COLLECTION ACTIONS BY PERSONS PERFORMING SERVICES
15 UNDER QUALIFIED TAX COLLECTION CONTRACTS.—

16 (1) IN GENERAL.—Subchapter B of chapter 76
17 (relating to proceedings by taxpayers and third par-
18 ties) is amended by inserting after section 7433 the
19 following new section:

20 “SEC. 7433A. CIVIL DAMAGES FOR CERTAIN UNAUTHORIZED
21 COLLECTION ACTIONS BY PERSONS PER-
22 FORMING SERVICES UNDER QUALIFIED TAX
23 COLLECTION CONTRACTS.

24 “(a) IN GENERAL.—Subject to the modifications pro-
25 vided by subsection (b), section 7433 shall apply to the acts